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THE FEDERAL TAXING POWER AND THE INCOME TAX

By ROBERT HANES GRAY*

IT HAS BEEN SAID that income subject to the federal income tax should be computed in the same general manner as income for ordinary accounting purposes.¹ Any substantial variation between net income and taxable net income requires laborious and expensive audits, adjustments, memoranda and reconciliations on the part of the taxpayer and causes an undue increase in the costs of administration and collection on the part of the government.²

At best, taxation is not a subject which is considered with enthusiasm by the taxpayer. The collection of a just tax is prone to cause momentary unhappiness to even the most public-spirited citizen. But when a tax is unfair, or is harshly administered, his reaction is frequently painful to his associates and eventually detrimental to the existing form of government.³ A tax which purports to be a tax on income but which obviously taxes a great

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¹For example, see Haig, *The Concept of Income—Economic and Legal Aspects*, in Haig, *The Federal Income Tax* (1921) 16; Montgomery, *Income Tax Procedure* (1923) 400; Report of the Committee on Federal Taxation, American Institute of Accountants, (1937) 64 *Journal of Accountancy* 349; Preliminary Report of the Committee Appointed by the National Tax Association to Prepare a Plan of a Model System of State and Local Taxation (1918) 15. For a reference to this argument, see the testimony of Roswell Magill representing the United States Treasury Department, Hearings Before the Committee on Ways and Means on Revenue Revision 1938, 75th Cong., 3d Sess. (1938) 143.

²Gilman, *Accounting Concepts of Profit* (1939) 16.

³"At all times liberty has been inseparably linked with taxation in whatever form it may be applied." Peck and Thorpe, *Neither Purse Nor Sword* (1936) 168. "For nearly a thousand years the Anglo-Saxon race has been fighting its way to freedom, and the struggle has largely taken the form of resisting unjust taxation. On that issue Magna Charta was wrested from King John, and on that issue these United States came into being." Abbott, *Justice and the Modern Law* (1913) 212.

deal more inevitably causes dissatisfaction⁴ and leads to evasion, perjury and corruption.⁵ Every consideration of policy indicates that the income tax statute should incorporate as nearly as possible an orthodox conception of "income."

The drafting of such a statute is difficult enough under the most favorable conditions. Economists, accountants and judges have disagreed for years on the meaning of income.⁶ Yet in spite of the confusion which still exists, various accounting, economic and legal organizations continue to investigate the problem. And as the result of their activities and of the work of independent specialists certain generally accepted principles are beginning to emerge.⁷ Although the outlines of the income concept are vague and wavering they are becoming constantly clearer.

The income tax under the sixteenth amendment has reflected to a gratifying extent the development in the understanding of the meaning of income.⁸ After the 1913 Act⁹ accountants and

⁴Peloubet, *Depreciation Under the Revenue Act of 1934*, (1934) 58 *Journal of Accountancy* 169, 197, 198. See also Beale, *The Measure of Income for Taxation*, (1911) 19 *J. of Pol. Econ.* 655, 656.

⁵Judge Cooley thought that this would be the result under any income tax. "An income tax is objectionable, because it is inquisitorial, and because it teaches the people evasion and fraud. No means at the command of the government has ever enabled it to arrive with anything like accuracy at the incomes of its citizens, and they resist its inquisitions with all practical modes." Cooley, *Taxation* (1876) 20. Andrew Carnegie, while favoring an inheritance tax, held similar views concerning the income tax. Editorial, *The Independent*, December 20, 1906, p. 1502. See also Post, *The Income Tax*, *The Outlook*, March 2, 1907, p. 503, 505 et seq. "Mr. Gladstone's dictum that an income tax made a nation of liars, and that nothing does more to demoralize and corrupt the people, could certainly not be challenged by an appeal to American experience." Editorial, (1913) 58 *Living Age* 698, 699.

⁶For example, see Hewett, *The Definition of Income and Its Application in Federal Taxation* (1925) 8, 9; Rottschaefer, *The Concept of Income in Federal Taxation*, (1929) 13 *MINNESOTA LAW REVIEW* 637, 638; Wueller, *Concepts of Taxable Income I*, (1938) 53 *Pol. Sci. Q.* 83, 84. Cf. Haig, *The Concept of Income—Economic and Legal Aspects*, in Haig, *The Federal Income Tax* (1921) 11. For the judicial confusion and uncertainty, see Magill, *Taxable Income* (1936) ch. 12; Spahr, *The Supreme Court on the Incidence and Effects of Taxation* (1925) ch. 1; Buehler, *Public Finance* (1936) 417. For statements concerning the uncertainty in accounting see Greer, *What Are Accepted Principles of Accounting?* (1938) 13 *Accounting Review* 25; Brink, *The Need for Single-Purpose Statements*, (1940) 69 *Journal of Accountancy* 284; Ballantine, *Taxable Income*, (1925) 40 *Journal of Accountancy* 349, 350. See also, Thomas, *Federal Income Taxation*, (1939) 67 *Journal of Accountancy* 15, 16, 17. Clark, *Eisner v. Macomber and Some Income Tax Problems*, (1920) 29 *Yale L. J.* 735, 737.

⁷For recent statements of basic theory see Sanders, Hatfield, and Moore, *A Statement of Accounting Principles* (1938); Paton and Littleton, *An Introduction to Corporate Accounting Standards* (1940).

⁸See the address of Charles D. Hamel, former Chairman of the Board of Tax Appeals, (1924) 3 *The Certified Public Accountant* 273; Kirkham, *Depreciation Under the Income Tax*, (1936) 11 *Accounting Review* 345,

economists played an increasingly important part in the evolution of an acceptable tax statute.¹⁰ Many of the objectionable features of the original act were removed, greater reliance was placed upon sound accounting principles and the nation seemed to be well on the way to achieving a highly equitable method of raising the public revenue.

Unfortunately, in recent years there have been powerful forces running counter to the trend which had been developing for almost two decades. The depression and its consequent diminution of revenue, the rearmament program and its demand for additional funds have placed legislative committees under tremendous pressure. In investigating all possible sources of revenue it was inevitable that the deduction provisions of the income tax should be questioned.¹¹ A denial of a deduction would be the equivalent of a discovery of a new source of revenue, and collections could be greatly increased without a corresponding increase in rates.¹²

372; Moyer, *The Income Tax—Accounting Aspects*, (1928) 3 *Accounting Review* 18, 20; Committee on Federal Taxation, *Federal Tax Revision Program*, (1939) 68 *Journal of Accountancy* 305; Harrow, *The Supreme Court on Accounting Matters*, (1929) 15 *A. B. A. J.* 607, 608.

⁹38 Stat. at L. 166. Congressman Cordell Hull requested a committee of accountants to "frame an income-tax law which would indicate its ideas and which he could use as a framework around which to build the act which would be finally enacted. This the committee did, and a few scattered fragments of its language are to be found in the respectable parts of the act of 1913 and each of the succeeding revenue acts, but in the main Congress itself constructed and should be responsible for the 1913 law, with its crudities and absurdities." Gore, *From Wickersham to Mellon*, (1926) 42 *Journal of Accountancy*, 269, 272. See also, Moyer, *The Income Tax—Accounting Aspects*, (1928) 3 *Accounting Review* 18, 20.

¹⁰Gore, *Report of the President, American Institute of Accountants*, (1924) 38 *Journal of Accountancy* 321, 322; Hamel, *The Board of Tax Appeals*, (1924) 38 *Journal of Accountancy* 327.

¹¹The sub-committee report on the Revenue Act of 1934 recommended that deductions for depletion and depreciation be reduced by twenty-five percent for the years 1934, 1935, 1936. While recognizing the soundness of such allowances from an accounting standpoint it was pointed out that they did not represent cash outgo like wages, repairs and similar expense and furthermore the amount of the allowance was a very uncertain factor since it depended upon the estimated life of the property. Preliminary Report of a Sub-Committee on Ways and Means on Prevention of Tax Avoidance, 73rd Cong., 2d Sess. (1933) 4, 5. (1936) 36 *Col. L. Rev.* 274.

¹²In 1932 individual returns showed income totaling \$13,764,294,643, and in 1933 the total income amounted to \$13,117,545,254, while during the same years deductions amounted to \$2,578,795,334 and \$2,271,891,722 respectively. Statistics of Income for 1932 (1934) 7; Statistics for Income for 1933 (1934) 7. Corporate statistics are much more startling. For example, corporate tax returns in 1936 showed deductions for depreciation amounting to \$1,456,292,000, officers' salaries \$1,323,073,000, interest expense \$798,845,000 and rent paid \$592,622,000. Since the reported net income for income tax computation amounted to only \$5,428,109,000 a denial of these deductions alone would almost double the revenues collected from corporations. Hearings Before the Committee on Finance, 75th Cong., 3d Sess.

If Congress should enact legislation limiting or denying the right to make the usual deductions from gross income,¹⁸ does the constitution offer the taxpayer any protection? The question is an important one during ordinary times; it becomes immeasurably more important during a period when income tax rates are greatly increased.

I.

Conventional discussions of the sixteenth amendment¹⁴ revolve around the problem of distinguishing capital from income. It is pointed out that regardless of whether income is defined as the "gain derived from capital, from labor, or from both combined,"¹⁵ or as the "money value of the net accretion to one's economic power between two points of time,"¹⁶ or as "the surplus remaining . . . after providing for all costs, expenses and allowances for accrued or probable losses,"¹⁷ the definitions of the judge, the economist and the accountant are in agreement on one point at least: income represents gain.

If the sixteenth amendment permits only the taxation of income it would necessarily follow that a tax under the amendment which included something more than the net profit of a transaction would be in effect a tax on the return of capital and invalid. The emphasis of the Supreme Court on the word "gain" has led many to suggest that the income concept of the

(1938) 688, 689. It was estimated that the twenty-five per cent reduction of the allowance for depletion and depreciation would result in an increase in revenue of about \$85,000,000 annually. Preliminary Report of a Subcommittee on Ways and Means on Prevention of Tax Avoidance, 73rd Cong., 2nd Sess. (1933) 4, 5.

¹³"No one really likes to pay taxes, but it is much pleasanter to pay a tax if it is imposed in a clear, definite way and applies equally to all taxpayers who live or work under substantially the same conditions. It is, however, intolerable to be told that your tax rates have not increased, or have only increased a small percentage, and to be told in the same breath that you will pay more tax because deductions are going to be denied or reduced. There is neither scientific basis nor common sense in this method of taxation. The only fair thing to do is to define income and expenses in a simple, understandable, accurate manner and raise more revenue by increasing rates." Peloubet, *Depreciation Under the Revenue Act of 1934*, (1934) 58 *Journal of Accountancy* 169, 197.

¹⁴United States constitution, amendment XVI: "The Congress shall have the power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

¹⁵*Stratton's Independence, Ltd. v. Howbert*, (1913) 231 U. S. 399, 34 Sup. Ct. 136, 58 L. Ed. 285; *Eisner v. Macomber*, (1920) 252 U. S. 189, 40 Sup. Ct. 189, 64 L. Ed. 521.

¹⁶Haig, *The Concept of Income—Legal and Economic Aspects*, in Haig, *The Federal Income Tax* (1921) 27.

¹⁷Montgomery, *Auditing—Theory and Practice* (4th ed. 1927) 360.

sixteenth amendment is a net income concept rather than a gross income or even an intermediate concept.¹⁸

To deny a taxpayer the right to deduct from his gross receipts the full amount of the expense incurred in securing the receipts results in the taxation of capital.¹⁹ Therefore, if a tax on income was substantially the same as a direct tax,²⁰ a fortiori a tax on a mere conversion of capital was a direct tax and both were invalid unless apportioned. The sixteenth amendment has relieved Congress of the necessity of apportionment in the former case but not in the latter.²¹

So runs the argument which would deny Congress the power to tax as income anything which was not income; and a substantial number of cases apparently sustain this contention. In *Goodrich v. Edwards*²² the Court held that there was no taxable gain where the stockholder sold shares held as an investment for an amount which was more than the March 1, 1913 value but which was less than original cost. Since the statute expressly provided for the inclusion in gross income of the difference between the 1913 value and the selling price,²³ the case would appear to be authority for the contention that Congress may tax only net income.²⁴ An earlier case, *Doyle v. Mitchell Bros. Co.*,²⁵ involved

¹⁸For example, see Tuller, *The Taxing Power* (1937) 377, 378; Powell, *Constitutional Aspects of Federal Income Taxation*, in Haig, *Federal Income Tax* (1921) 51; Clark, *Can Congress Tax "Gross Income" under the Sixteenth Amendment?* (1922) 8 A. B. A. J. 513; Rottschaefer, *The Concept of Income in Federal Taxation*, (1929) 13 MINNESOTA LAW REVIEW 637; Kollenberg, *Taxable Income Under the Sixteenth Amendment*, (1931) 9 Tax Mag. 87. Montgomery, *Accounting and the Concept of Income*, in Magill, *Lectures on Taxation* (1932) 56.

¹⁹See Dohr, *Income Divorced from Reality*, (1938) 66 *Journal of Accountancy* 361; Montgomery, *Accounting and the Concept of Income*, in Magill, *Lectures on Taxation* (1932) 39.

²⁰*Pollock v. Farmers Loan & Trust Co.*, (1895) 157 U. S. 429, 15 Sup. Ct. 673, 39 L. Ed. 759.

²¹*Eisner v. Macomber* (1920) 252 U. S. 189, 40 Sup. Ct. 189, 64 L. Ed. 521; *Bowers v. Kerbaugh-Empire Co.*, (1926) 271 U. S. 170, 174, 46 Sup. Ct. 449, 451, 70 L. Ed. 886; *Taft v. Bowers*, (1929) 278 U. S. 470, 481, 49 Sup. Ct. 199, 201, 73 L. Ed. 460.

²²(1921) 255 U. S. 527, 41 Sup. Ct. 390, 65 L. Ed. 758.

²³"For the purpose of ascertaining the gain derived from the sale or other disposition of property . . . the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived." (1916) 39 Stat. at L. 757; (1917) 40 Stat. at L. 300, 307. Magill, *Taxable Income* (1936) 316.

²⁴However, the government confessed error in making the assessment so the question was not fully argued. (1921) 255 U. S. 527, 534, 41 Sup. Ct. 390, 65 L. Ed. 758. But in *United States v. Flannery*, (1925) 263 U. S. 98, 103, 104, 45 Sup. Ct. 420, 69 L. Ed. 865 the Court said that "the decision shows that it was not based on the confession of error or any constitutional

the deduction section of the Corporation Excise Tax Act of 1909.²⁶ The lumber company claimed a deduction for the December 31, 1908 value of the stumpage cut during the taxable year. In sustaining the contention of the corporation, the Court said that

"it is plain, we think, that by the intent and meaning of the act the entire proceeds of a mere conversion of capital assets were not to be treated as income. . . . In order to determine whether there has been gain or loss, and the amount of gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration."²⁷

While it is true that the decision involved the interpretation of "income" as used in the 1909 Act,²⁸ the Supreme Court has frequently remarked that the meaning of income as used in the amendment must be taken in its commonly understood sense²⁹ and the case at least indicates its meaning as then understood by the Court. Furthermore, at least one case has suggested that the meaning of income in the amendment is the same as its meaning in the 1909 Act.³⁰ But whatever may be its true significance, the

question . . . but . . . as a matter of construction . . . the statute imposed a tax upon gains only. (Italics supplied.)

²⁵(1918) 247 U. S. 179, 38 Sup. Ct. 467, 62 L. Ed. 1054.

²⁶(1909) 36 Stat. at L. 11, 112.

²⁷(1918) 247 U. S. 179, 184, 38 Sup. Ct. 467, 62 L. Ed. 1054. It should be noted, however, that the Court was speaking of "the intent and meaning of the act." See *infra*, note 244. Subsequent cases failed to note this distinction and the decision has been cited in connection with the constitutional power of Congress. "No confusion of thought can be more disastrous from the legal standpoint than a confusion between the constitutional approach and the interpretative approach to a question." Paul, *Selected Studies in Federal Taxation* (1938) 149.

²⁸It has been frequently stated that the meaning of income in the acts following the sixteenth amendment is the same as its meaning in the 1909 Act. See *Southern Pacific Co. v. Lowe*, (1918) 247 U. S. 330, 335, 38 Sup. Ct. 540, 542, 68 L. Ed. 1142; *Merchants' Loan & Trust Co. v. Smietanka*, (1921) 255 U. S. 509, 519, 41 Sup. Ct. 386, 389, 65 L. Ed. 751; *Edwards v. Cuba Railroad*, (1925) 268 U. S. 628, 631, 45 Sup. Ct. 614, 615, 69 L. Ed. 1124; *Bowers v. Kerbaugh-Empire Co.*, (1926) 271 U. S. 170, 174, 46 Sup. Ct. 449, 451, 70 L. Ed. 886; *Burnet v. Harmel*, (1932) 287 U. S. 103, 108, 53 Sup. Ct. 74, 76, 77 L. Ed. 199.

²⁹For example, see *Lynch v. Hornby*, (1918) 247 U. S. 339, 344, 38 Sup. Ct. 543, 545, 63 L. Ed. 1149; *Merchants' Loan & Trust Co. v. Smietanka*, (1921) 255 U. S. 509, 519, 41 Sup. Ct. 386, 389, 65 L. Ed. 751; *United States v. Safety Car Heating & Lighting Co.*, (1936) 297 U. S. 88, 99, 56 Sup. Ct. 353, 358, 80 L. Ed. 500. See also, Holmes, J., dissenting in *Eisner v. Macomber*, (1919) 252 U. S. 189, 219, 40 Sup. Ct. 189, 197, 64 L. Ed. 521.

³⁰*Bowers v. Kerbaugh-Empire Co.*, (1926) 271 U. S. 170, 174, 46 Sup. Ct. 449, 451, 70 L. Ed. 886.

Mitchell Bros. Case has been cited with approval by a number of decisions arising under the sixteenth amendment income tax acts.³¹ As was said in *Eisner v. Macomber*,³²

"It becomes essential to distinguish between what is and what is not 'income.' . . . Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the constitution."

And the Court in *Edwards v. Cuba Railroad*³³ said that

"The sixteenth amendment, like other laws authorizing or imposing taxes, is to be taken as written and is not to be extended beyond the meaning clearly indicated by the language used."³⁴

Subsidy payments made to the railroad by the Republic of Cuba "were not profits or gains from the use or operation of the railroad, and do not constitute income within the meaning of the sixteenth amendment."³⁵

Thus it would seem clear that strong arguments could be advanced to support the contention that the amendment does not authorize Congress to tax the full receipts from an enterprise or transaction, but that the taxpayer must be permitted to deduct the capital expended in securing the receipts before an income tax can be laid and collected; and if Congress may tax only that part of a transaction which represents income it goes without saying that Congress may not tax as income an event which contains no element of profit.

Yet any statement which assumes an implied limitation upon

³¹In *Southern Pacific Co. v. Lowe*, (1918) 247 U. S. 330, 335, 38 Sup. Ct. 540, 542, 68 L. Ed. 1142, the Court said: "We must reject in this case, as we have rejected in cases arising under the Corporation Excise Tax Act of 1909 the broad contention . . . that all receipts—that everything that comes in—are income within the proper definition of the term 'gross income,' and that the entire proceeds of a conversion of capital assets, in whatever form and under whatever circumstances accomplished, should be treated as gross income." In *Burnet v. Thompson Oil & Gas Co.*, (1931) 283 U. S. 301, 307, 51 Sup. Ct. 418, 420, 75 L. Ed. 1049, the Court cited the *Mitchell Bros. Case* for the following proposition: "To ascertain gain on a sale of a capital asset, there must be subtracted from the sale price a sum sufficient to restore the value at the date of acquisition (or March 1, 1913)." And in *Burnet v. Logan*, (1931) 283 U. S. 404, 51 Sup. Ct. 550, 75 L. Ed. 1143, where the taxpayer sold shares of stock for cash and a portion of the ores to be recovered from certain mines, the Court held that no profit was realized until the payment on account of the extracted ore fully restored the taxpayer's capital. The authority for the decision was the statement from *Doyle v. Mitchell Bros. Co.* that "In order to determine whether there has been a gain or loss . . . we must withdraw from the proceeds an amount sufficient to restore the capital value."

³²(1920) 252 U. S. 189, 206, 40 Sup. Ct. 189, 193, 64 L. Ed. 521.

³³(1925) 268 U. S. 628, 45 Sup. Ct. 614, 69 L. Ed. 1124.

³⁴268 U. S. 628, 631, 45 Sup. Ct. 614, 615, 69 L. Ed. 1124.

³⁵268 U. S. 628, 633, 45 Sup. Ct. 614, 615, 69 L. Ed. 1124.

the power of Congress to tax should be critically examined. The framers of the constitution intended to give Congress ample power to raise revenue; there was no intention to repeat the mistakes of the articles of confederation.³⁶

The constitution expressly denies Congress the power to tax articles exported from any state;³⁷ except for this one prohibition its power to "lay and collect taxes, duties, imposts and excises"³⁸ is said to embrace "every conceivable power of taxation."³⁹ Although virtually unlimited in choice of subject, Congress is expressly restricted as to the methods which may be used in the exercise of its power to tax. All duties, imposts and excises must be uniform throughout the United States,⁴⁰ while capitation and direct taxes must be laid in proportion to the census or enumeration.⁴¹

This "plenary" power has met with surprisingly few judicial restraints.⁴² While the fifth amendment,⁴³ after some hesita-

³⁶Cf. *Boutwell*, *The Income Tax*, (1895) 160 *North American Review* 589, 590 et seq.

³⁷United States constitution, art. I, sec. 9. "No tax or duty shall be laid on articles exported from any state."

³⁸United States constitution, art. I, sec. 8. "The Congress shall have the power to lay and collect taxes, duties, imposts and excises."

³⁹*Brushaber v. Union Pacific R. Co.*, (1916) 240 U. S. 1, 12, 36 Sup. Ct. 236, 239, 60 L. Ed. 493. For a more recent case see *Chas. C. Steward Machine Co. v. Davis*, (1937) 301 U. S. 548, 581, 57 Sup. Ct. 883, 888, 81 L. Ed. 1279: "The subject-matter of taxation open to the power of the Congress is as comprehensive as that open to the power of the states . . . If the tax is a direct one, it shall be apportioned. . . . If it is a duty, impost, or excise, it shall be uniform. . . . Together, these classes include every form of tax appropriate to sovereignty."

⁴⁰United States constitution, art. I, sec. 8. "All duties, imposts, and excises shall be uniform throughout the United States."

⁴¹United States constitution, art. I, sec. 9. "No capitation or other direct tax shall be laid, unless in proportion to the census or enumeration herein before directed to be taken."

United States constitution, art. I, sec. 2. "Representatives and direct taxes shall be apportioned among the several states which may be included within this Union, according to their respective numbers, which shall be determined by adding to the whole number of free persons, including those bound to service for a term of years, and excluding Indians not taxed, three-fifths of all other persons."

⁴²See *Gilbert*, *Provisions of Federal Law Held Unconstitutional by the Supreme Court of the United States* (1936). The cases may be classified as follows: Intergovernmental immunity, *Collector v. Day*, (1871) 11 Wall. (U.S.) 113, 20 L. Ed. 122; *United States v. Railroad Co.*, (1873) 17 Wall. (U.S.) 322, 21 L. Ed. 597; *National Life Ins. Co. v. United States*, (1928) 277 U. S. 508, 48 Sup. Ct. 591, 72 L. Ed. 968; *Indian Motorcycle Co. v. United States*, (1931) 283 U. S. 570, 51 Sup. Ct. 601, 75 L. Ed. 1277; *Burnet v. Coronado Oil & Gas Co.*, (1932) 285 U. S. 393, 52 Sup. Ct. 443, 76 L. Ed. 815. Diminution of salaries of federal judges, *Evans v. Gore*, (1920) 253 U. S. 245, 40 Sup. Ct. 550, 64 L. Ed. 887; *Miles v. Graham*, (1925) 268 U. S. 501, 45 Sup. Ct. 601, 69 L. Ed. 1067. Unapportioned "income tax," *Pollock v. Farmers' Loan & Trust Co.*, (1895) 157 U. S.

tion,⁴⁴ has been invoked to limit the taxing power of Congress,⁴⁵ the actual cases striking down its revenue provisions have been few.⁴⁶ The problem of classification for tax purposes has caused

429, 15 Sup. Ct. 673, 39 L. Ed. 759; *Eisner v. Macomber*, (1920) 252 U. S. 189, 40 Sup. Ct. 189, 64 L. Ed. 521. Tax on exports, *Fairbank v. United States*, (1901) 181 U. S. 283, 21 Sup. Ct. 648, 45 L. Ed. 862; *United States v. Hvoslef*, (1915) 237 U. S. 1, 35 Sup. Ct. 459, 50 L. Ed. 813; *Thames & Mersey Marine Ins. Co. v. United States*, (1915) 237 U. S. 19, 35 Sup. Ct. 496, 59 L. Ed. 821; *Spalding & Bros. v. Edwards*, (1923) 262 U. S. 66, 43 Sup. Ct. 485, 67 L. Ed. 865. Improper use of taxing power for regulatory purposes, *Bailey v. Drexel Furniture Co.*, (1922) 259 U. S. 20, 42 Sup. Ct. 449, 66 L. Ed. 817; *Hill v. Wallace*, (1922) 259 U. S. 44, 42 Sup. Ct. 453, 66 L. Ed. 822; *Trusler v. Crooks*, (1926) 269 U. S. 475, 46 Sup. Ct. 165, 70 L. Ed. 365; *United States v. Constantine*, (1935) 296 U. S. 287, 56 Sup. Ct. 223, 80 L. Ed. 233; *United States v. Butler*, (1936) 297 U. S. 1, 56 Sup. Ct. 312, 80 L. Ed. 477; *Rickert Rice Mills v. Fontenot*, (1936) 297 U. S. 110, 56 Sup. Ct. 374, 80 L. Ed. 513; *Carter v. Carter Coal Co.*, (1936) 298 U. S. 238, 56 Sup. Ct. 855, 80 L. Ed. 1160. Retroactive excise taxes, *Nichols v. Coolidge*, (1927) 274 U. S. 531, 47 Sup. Ct. 710, 71 L. Ed. 1184; *Untermeyer v. Anderson*, (1928) 276 U. S. 440, 48 Sup. Ct. 353, 72 L. Ed. 645; *Heiner v. Donnan*, (1932) 285 U. S. 312, 52 Sup. Ct. 358, 76 L. Ed. 772.

⁴³United States constitution, amend. V: "No person . . . shall be deprived of life, liberty or property, without due process of law; nor shall private property be taken for public use, without just compensation."

⁴⁴Chief Justice White in *Brushaber v. Union Pacific R. Co.*, (1916) 240 U. S. 1, 24, 36 Sup. Ct. 236, 244, 60 L. Ed. 493, said that ". . . the due process clause of the fifth amendment . . . is not a limitation upon the taxing power conferred upon Congress by the constitution. . . ." The chief justice made a similar statement in *Billings v. United States*, (1914) 232 U. S. 261, 282, 34 Sup. Ct. 421, 424, 58 L. Ed. 596.

⁴⁵*McCray v. United States*, (1904) 195 U. S. 27, 24 Sup. Ct. 769, 49 L. Ed. 78; *Flint v. Stone Tracy Co.*, (1911) 220 U. S. 107, 31 Sup. Ct. 342, 55 L. Ed. 389; *Billings v. United States*, (1914) 232 U. S. 261, 34 Sup. Ct. 421, 58 L. Ed. 596; *Brushaber v. Union Pacific R. Co.*, (1916) 240 U. S. 1, 36 Sup. Ct. 236, 60 L. Ed. 493; *La Belle Iron Works v. United States*, (1921) 256 U. S. 377, 41 Sup. Ct. 528, 65 L. Ed. 998; *Haavik v. Alaska Packers Association*, (1924) 263 U. S. 510, 44 Sup. Ct. 177, 68 L. Ed. 414; *Bromley v. McCaughn*, (1929) 280 U. S. 124, 50 Sup. Ct. 46, 74 L. Ed. 226; *Cooper v. United States*, (1930) 280 U. S. 409, 50 Sup. Ct. 164, 74 L. Ed. 516; *Reinecke v. Smith*, (1933) 289 U. S. 172, 53 Sup. Ct. 570, 77 L. Ed. 1109; *United States v. Hudson*, (1937) 299 U. S. 498, 57 Sup. Ct. 309, 81 L. Ed. 370; *Cincinnati Soap Co. v. United States*, (1937) 301 U. S. 308, 57 Sup. Ct. 764, 81 L. Ed. 1122; *Tyler v. United States*, (1930) 281 U. S. 497, 50 Sup. Ct. 356, 74 L. Ed. 991; *Steward Machine Co. v. Davis*, (1937) 301 U. S. 548, 57 Sup. Ct. 883, 81 L. Ed. 1279; *United States Trust Co. v. Helvering*, (1939) 307 U. S. 57, 59 Sup. Ct. 692, 83 L. Ed. 1104; *United States v. Jacobs*, (1939) 306 U. S. 363, 59 Sup. Ct. 551, 83 L. Ed. 763.

"Except in rare and special instances, the due process of law clause contained in the fifth amendment is not a limitation upon the taxing power conferred upon Congress by the constitution." *A. Magnano Co. v. Hamilton*, (1934) 292 U. S. 40, 44, 54 Sup. Ct. 599, 601, 78 L. Ed. 1077.

⁴⁶*Nichols v. Coolidge*, (1927) 274 U. S. 531, 47 Sup. Ct. 710, 71 L. Ed. 1184 (retroactive application of the estate tax); *Untermeyer v. Anderson*, (1928) 276 U. S. 440, 48 Sup. Ct. 353, 78 L. Ed. 645 and *Blodgett v. Holden*, (1928) 275 U. S. 142, 276 U. S. 594, 48 Sup. Ct. 105, 72 L. Ed. 206 (retroactive application of the gift tax); *Heiner v. Donnan*, (1932) 285 U. S. 312, 52 Sup. Ct. 358, 76 L. Ed. 772 (estate tax on all gifts within two years of decedent's death).

little difficulty⁴⁷ and that of retroactive taxation only occasional and temporary inconvenience⁴⁸—and then over the objection of a powerful minority.⁴⁹ The doctrine that the power to tax may be used only for a public purpose has not been applied to federal as it has to state taxation.⁵⁰ Whatever may be the limitations upon the rapidly expanding spending power of Congress,⁵¹ it is fairly clear that a carefully drawn statute will avoid any serious constitutional difficulty on this score.⁵² Anticipatory legislation easily removes any doubt as to the power of Congress to tax federal officials,⁵³ while the power to tax state officials and employees is

⁴⁷In *Rottschaefer*, *Constitutional Law* (1939) 215, it is stated that "the Supreme Court has thus far never found a classification made by Congress in levying taxes to be so arbitrary as to violate due process, but has sustained numerous classifications as valid." But see *Heiner v. Donnan*, (1932) 285 U. S. 312, 52 Sup. Ct. 358, 76 L. Ed. 772 where an estate tax on all gifts made within two years of decedent's death was held invalid.

⁴⁸See note 44 *supra*.

⁴⁹See the dissent of Brandeis, J., with whom Holmes and Stone, JJ., concurred, in *Untermeyer v. Anderson*, (1928) 276 U. S. 440, 447, 48 Sup. Ct. 353, 355, 72 L. Ed. 645. "For more than half a century, it has been settled that the law of Congress imposing a tax may be retroactive in its operation."

⁵⁰See *Rottschaefer*, *Constitutional Law* (1939) 171.

⁵¹In *United States v. Butler*, (1936) 297 U. S. 1, 56 Sup. Ct. 312, 80 L. Ed. 477, the Court held that the spending power could not be used to regulate individual conduct in a field of authority exclusively reserved to the states.

⁵²In the *Butler* Case there was no question about the power of Congress to lay an excise tax on processors. See dissent of Stone, J. in 297 U. S. at 79. *Cincinnati Soap Co. v. United States*, (1937) 301 U. S. 308, 57 Sup. Ct. 764, 74 L. Ed. 991. In *Massachusetts v. Mellon*, (1923) 262 U. S. 447, 487, 488, 43 Sup. Ct. 597, 67 L. Ed. 1078, the Court said that the interest of a taxpayer in the "moneys in the treasury . . . is shared with millions of others, is comparatively minute and indeterminable, and the effect upon future taxation, of any payment out of the funds, so remote, fluctuating and uncertain, that no basis is afforded for an appeal to the preventive powers of a court of equity." And that "The party who invokes the power must be able to show, not only that the statute is invalid, but that he has sustained or is immediately in danger of sustaining some direct injury as the result of its enforcement, and not merely that he suffers in some indefinite way in common with people generally." Because of this insufficient interest of a taxpayer in the payment of money by the government, it has been suggested that a tax on processors in a revenue act and a separate statute appropriating money to farmers on condition that they reduce acreage might meet the constitutional objection of the *Butler* Case. (1936) 49 *Harv. L. Rev.* 828, 829.

⁵³In *Evans v. Gore*, (1920) 253 U. S. 245, 40 Sup. Ct. 550, 64 L. Ed. 887 and in *Miles v. Graham*, (1925) 268 U. S. 501, 45 Sup. Ct. 601, 69 L. Ed. 1067, the Supreme Court held that an inclusion of a federal judge's salary in his gross income violated art. III, sec. 1 of the United States constitution since it amounted to a diminution of salary during continuance in office. In 1932 Congress again provided for the inclusion of such salaries in the taxpayer's gross income but expressly limited the tax to those judges who took office after the effective date of the act. (1932) 47 *Stat. at L.* 169. In *O'Malley v. Woodrough*, (1939) 307 U. S. 277, 59 Sup. Ct. 838, 83 L. Ed. 1289, the act was sustained and the two earlier cases

no longer questioned.⁵⁴ These decisions have also cast serious doubt upon the immunity of state and local bonds from federal taxation.⁵⁵

In view of the broad power of Congress to lay and collect taxes and of the relatively few implied limitations read into the constitution by the Supreme Court, it would appear that the observation made some twenty years ago that "the constitutional aspects of federal income taxation are relatively unimportant"⁵⁶ applies with even greater force today. As long as capitation and direct taxes are apportioned and all other taxes are uniform, the taxpayer must seek relief through legislative rather than through judicial channels. The constitution affords him little protection.

Yet the very fact that there is a requirement that indirect taxes must be uniform and that direct taxes must be apportioned offers an opportunity to assert a claim of unconstitutionality. Since the uniformity clause has been interpreted to mean territorial uniformity,⁵⁷ there has been no successful attack on this basis. However, the same has not been true of the requirement that direct taxes be apportioned; here opponents of federal tax legislation have met with at least temporary success.

II.

Within a few years after the ratification of the constitution, Congress was forced to supplement its revenue⁵⁸ by means of in-

overruled to the extent that they were inconsistent with the latter opinion. Section 3 of the Public Salary Tax Act of 1939 removed the limitation of the 1932 Act and all judges, regardless of time of appointment, are subject to the federal income tax. The salary of the president of the United States is likewise subject to the tax. (1932) 47 Stat. at L. 169 and subsequent enactments. See Blakey, *The Federal Income Tax* (1940) 460-462.

⁵⁴In *Collector v. Day*, (1870) 11 Wall. (U.S.) 113, 20 L. Ed. 122, the Court held that the salary of a state judge was not subject to a federal income tax. This case was expressly overruled by *Graves v. O'Keefe*, (1939) 306 U. S. 466, 486, 59 Sup. Ct. 595, 601, 83 L. Ed. 927. Although the case involved a state tax on a federal employee, the Court said that the case was overruled so far as it recognized "an implied constitutional immunity from income taxation of the salaries of officers and employees of the . . . state government or their instrumentalities." See *Helvering v. Gerhardt*, (1938) 304 U. S. 405, 58 Sup. Ct. 969, 82 L. Ed. 1427; (1939) 1 Wash. & Lee L. Rev. 67.

⁵⁵I. R. C. (1939) sec. 22(b) (4) expressly excludes such interest from the federal tax. See the writer's discussion in *Derivative Tax Immunity and the Income from State Bonds*, (1941) 41 Col. L. Rev. 1357.

⁵⁶Powell, *Constitutional Aspects of Federal Income Taxation*, in Haig, *The Federal Income Tax*, (1921) 51.

⁵⁷*Knowlton v. Moore* (1900) 178 U. S. 41, 20 Sup. Ct. 747, 44 L. Ed. 969; *Brushaber v. Union Pacific R. Co.*, (1916) 240 U. S. 1, 36 Sup. Ct. 236, 60 L. Ed. 493; *Chas. C. Steward Machine Co. v. Davis*, (1937) 301 U. S. 548, 57 Sup. Ct. 883, 81 L. Ed. 1279.

⁵⁸Existing tonnage and customs duties were estimated to yield \$1,467,-086 while the annual expenses of the civil establishment of the new govern-

ternal taxes since the duties on imports⁵⁹ proved to be inadequate. In 1791 Congress laid a duty on each gallon of spirits distilled in the United States and an annual duty on "country" stills measured by production capacity.⁶⁰ Whatever issues may have been raised by the tax,⁶¹ that of unconstitutionality for want of apportionment does not appear to have been one of them. The power to tax manufactured products or the means required for their production was taken as a matter of course, particularly in view of the fact that the article in question was considered by some to be in the class of luxuries.⁶²

Three years later Congress again sought to secure additional revenue. A tax was laid upon "all carriages for the conveyance of persons . . . for his or her own use, or to be let to hire, or for the conveyance of passengers."⁶³ In addition to the carriage tax Congress also imposed a tax on dealers in wines and liquors,⁶⁴ a tax on all sugar refined in the United States and a tax on all snuff manufactured for sale within the United States,⁶⁵ and a tax on auction sales.⁶⁶

Although these taxes were only temporary measures,⁶⁷ the fact that within less than four years after the constitution went into effect a tax on property⁶⁸ was sponsored and enacted by men who had participated in the constitutional convention would appear to be significant.⁶⁹ Taxes on spirits had been known in England and in the colonies and had not been considered as direct taxes⁷⁰—and

ment amounted to \$630,101 and accrued interest and overdue bonds amounted to \$15,000,000. 1 State Papers, Finance 12.

⁵⁹(1789) 1 Stat. at L. 24.

⁶⁰(1791) 1 Stat. at L. 199.

⁶¹E.g., the Whiskey Rebellion of 1794. Comstock, *Excises in Modern Times*, (1936) 183 *Annals, Am. Academy Pol. and Soc. Sci.* 111.

⁶²Howe, *Taxation in the United States under the Internal Revenue System* (1896) 17.

⁶³(1794) 1 Stat. at L. 373.

⁶⁴(1794) 1 Stat. at L. 376.

⁶⁵(1794) 1 Stat. at L. 384.

⁶⁶(1794) 1 Stat. at L. 397. The tax was limited to the sale of land and certain specified types of other property. Its amount was determined by the "purchase money arising by the sale."

⁶⁷These taxes were repealed in 1802. 2 Stat. at L. 148.

⁶⁸*Jones, Pollock v. Farmers' Loan & Trust Co.*, (1895) 9 *Harv. L. Rev.* 198, 210. See also Seligman, *The Income Tax Amendment*, (1910) 25 *Pol. Sc. Q.* 193, 196.

⁶⁹See *Hampton & Co. v. United States*, (1928) 276 U. S. 394, 411, 412, 48 *Sup. Ct.* 348, 353, 72 *L. Ed.* 624.

⁷⁰For many illustrations, see *Opinion of the Justices*, (1908) 196 *Mass.* 603, 85 *N. E.* 545.

this was equally true of the tax on snuff and sugar. With regard to the tax on carriages, however, there was a more serious dispute.⁷¹

In *Hylton v. United States*⁷² the Supreme Court for the first time passed upon the constitutionality of an act⁷³ of Congress.⁷⁴ In a fictitious statement of facts it was alleged that the taxpayer kept one hundred and twenty-five chariots "exclusively for the defendant's own private use and not for hire."⁷⁵ Counsel on both sides were paid by the government⁷⁶ and only three of the six judges participated in the decision.⁷⁷ However the three justices were clearly of the opinion that the only direct taxes were taxes on real property and the capitation tax. Paterson, one of the three taking part in the case, had been a member of the convention, as had Wilson, who expressed an opinion in the court below. The latter justice did not join in the opinion of the Court but he did say that his "sentiments in favor of the constitutionality of the tax [had] not been changed."⁷⁸

Thus the Supreme Court finally answered Rufus King's question.⁷⁹ Direct taxes are taxes on land. Capitation taxes and taxes on land must be apportioned, all other taxes must be uniform. Unless it can be said that the framers of the constitution intended to adopt the physiocrats' definition of a direct tax,⁸⁰ those members of the convention who afterwards had a hand in its practical operation ignored the then current views of the economists.⁸¹

⁷¹Madison strongly opposed the measure as a direct tax. In a letter dated May 11, 1794 he said: "The tax on carriages succeeded in spite of the Constitution." 2 Madison (1865) 14. Hamilton, of course, favored it since he had proposed a tax on carriages as early as 1790. 1 State Papers, Finance 43.

⁷²(1796) 3 Dall. (U.S.) 171, 1 L. Ed. 335.

⁷³(1794) 1 Stat. at L. 373.

⁷⁴(1935) 1 Warren, The Supreme Court in United States History 147.

⁷⁵Ibid.

⁷⁶Ibid.

⁷⁷Chase, Paterson and Iredell. Cushing had been ill, Wilson gave no opinion and Ellsworth was not sworn in until the day the decision was delivered.

⁷⁸(1796) 3 Dall. (U.S.) 171, 184, 185, 1 L. Ed. 335.

⁷⁹During the course of the debates at the constitutional convention, "Mr. King asked what was the precise meaning of direct taxation. No one answered." 5 Madison (1865) 451.

⁸⁰I.e., all taxes except capitation and taxes on land may be shifted. Hewett, *The Definition of Income and Its Application in Federal Taxation*, (1925) 1; see also Seligman, *Is the Income Tax Constitutional and Just*, 19 *The Forum* 48; West, *The Income Tax and the National Revenue* (1900) 8 *J. of Pol. Econ.* 433, 434.

⁸¹"The Physiocrats and Adam Smith had recently made popular a distinction between direct and indirect taxes." Spahr, *The Supreme Court on the Incidence and Effects of Taxation* (1925) 1.

Looking to the reason for the apportionment clauses⁸² and realizing that the southern land and slaveholders had nothing to fear from a uniform personal property tax, both Congress and the Supreme Court reached the conclusion that there was no intention on the part of those who incorporated the apportionment requirement into the Constitution to classify such taxes as direct.

The emergency internal revenue measures brought on by the War of 1812 included the revival of the carriage,⁸³ sugar refining,⁸⁴ liquor license⁸⁵ and auction sales taxes.⁸⁶ In addition a stamp tax on bonds, promissory notes and bills of exchange was introduced.⁸⁷ These revenues proving inadequate, a tax on sundry manufactured products⁸⁸ and a graduated tax on household furniture was enacted in 1816.⁸⁹

It should be noted that Congress again laid taxes on personal property without any attempts at subterfuge. A personal property tax was not a direct tax and there was no occasion to adopt a "devious and delusive"⁹⁰ method of achieving a result which could be obtained by direct methods. The *Hylton Case* clearly explained the apportionment provision, and Congress acted accordingly.

⁸²Paterson, J., a member of the constitutional convention, said that "The provision was made in favor of the southern states. They possessed a large number of slaves; and had extensive tracts of territory, thinly settled, and not very productive. A majority of the states had but few slaves, and several of them a limited territory, well settled, and in a high state of cultivation. The southern states, if no provision had been introduced into the constitution, would have been wholly at the mercy of other states. Congress in such case, might tax slaves, at discretion or arbitrarily, and land in every part of the Union at the same rate or measure: so much a head in the first instance, and so much an acre in the second. To guard them against imposition in these particulars, was the reason of introducing the clause in the Constitution, which directs that representatives and direct taxes shall be apportioned among the states, according to their respective numbers." *Hylton v. United States*, (1796) 3 Dall. (U.S.) 171, 177, 1 L. Ed. 335.

⁸³(1813) 3 Stat. at L. 40.

⁸⁴(1813) 3 Stat. at L. 35.

⁸⁵(1813) 3 Stat. at L. 42 (distillers); (1813) 3 Stat. at L. 72 (dealers).

⁸⁶(1813) 3 Stat. at L. 44.

⁸⁷(1813) 3 Stat. at L. 77.

⁸⁸The tax was laid on pig iron; castings, bar iron, rolled or slit iron; nails, brads, and sprigs; and candles—all to be taxed at specified rates according to weight. There was also a tax on hats and caps; umbrellas; paper; playing cards; beer, ale and porter; tobacco; manufactured "segars" and snuff; leather and sundry leather products—all to be taxed ad valorem. (1816) 3 Stat. at L. 180.

⁸⁹(1816) 3 Stat. at L. 186.

⁹⁰From the remarks of Sutherland, J., dissenting in *Hale v. Iowa State Board of Assessment and Review*, (1937) 302 U. S. 95, 111, 58 Sup. Ct. 102, 108, 82 L. Ed. 72.

Taxes levied on land in 1798,⁹¹ 1813,⁹² 1814,⁹³ and 1815⁹⁴ were duly apportioned; all others were uniform.

Having had no occasion to employ subtle methods of draftsmanship, the Civil War revenue acts were enacted in accordance with the principles of the *Hylton Case*. In 1861 a tax on real estate was enacted and duly apportioned.⁹⁵ The income tax was uniform.⁹⁶ Subsequent taxes on incomes,⁹⁷ gross receipts,⁹⁸ businesses,⁹⁹ transactions,¹⁰⁰ successions,¹⁰¹ auction sales¹⁰² and commodities¹⁰³ were not apportioned but met the requirement of uniformity.

Conforming to its earlier decisions, the Court interposed no constitutional objection to these levies. In *Pacific Insurance Co. v. Soule*¹⁰⁴ the tax on dividends and undistributed profits of insurance companies was sustained. *Veazie Bank v. Fenno*¹⁰⁵ permitted Congress to lay a prohibitive tax on state bank notes and while there was some dissent as to the validity of the statute, there was none on the ground that the tax was not apportioned. *United States v. Singer*¹⁰⁶ sustained a tax on distillers, the minimum duty to be not less than eighty per cent of the productive capacity of the plant.

⁹¹(1798) 1 Stat. at L. 597 (levied to meet a treasury deficiency and to pay debts due to the United States Bank).

⁹²(1813) 3 Stat. at L. 53.

⁹³(1815) 3 Stat. at L. 164.

⁹⁴(1816) 3 Stat. at L. 255.

⁹⁵(1861) 12 Stat. at L. 292.

⁹⁶(1861) 12 Stat. at L. 292.

⁹⁷(1862) 12 Stat. at L. 432; (1864) 12 Stat. at L. 713; (1867) 14 Stat. at L. 471; (1870) 16 Stat. at L. 256. But see Curtis, *The Revenue Powers of the United States* (1866) 33 *Harper's Magazine* 354, for a criticism of this tax.

⁹⁸Gross receipts from toll-bridges and from passenger traffic of railroads, boats and ferries; gross receipts of insurance companies; gross receipts from advertising, (1862) 12 Stat. at L. 422; gross receipts of express companies, (1863) 12 Stat. at L. 713; the gross receipts of telegraph companies, lotteries, theatres, operas, circuses and museums, (1864) 13 Stat. at L. 223.

⁹⁹Some thirty-three businesses and professions were required to pay a license tax. See Smith, *The U. S. Federal Internal Tax History* (1914) 167, 313-317.

¹⁰⁰For a list of legal instruments and proprietary articles subject to a stamp tax see Smith, *The U. S. Federal Internal Tax History*, (1914) 304-310.

¹⁰¹(1862) 12 Stat. at L. 448.

¹⁰²(1862) 12 Stat. at L. 432. During the following year sales of brokers were also taxed, (1873) 13 Stat. at L. 223.

¹⁰³The list of commodities subject to the tax was very comprehensive, consisting chiefly of manufactured products, (1862) 12 Stat. at L. 432.

¹⁰⁴(1869) 7 Wall. (U.S.) 433, 19 L. Ed. 95.

¹⁰⁵(1869) 8 Wall. (U.S.) 533, 19 L. Ed. 482.

¹⁰⁶(1872) 15 Wall. (U.S.) 111, 21 L. Ed. 49.

In *Scholey v. Rew*¹⁰⁷ the Court held that the right to take *real estate* by descent or devise was a proper subject of an unapportioned tax. In 1880 the Supreme Court in *Springer v. United States*¹⁰⁸ passed upon the validity of the income tax. After reviewing the background of the apportionment clause and the reasoning of the *Hylton Case*,¹⁰⁹ the Court expressed its complete agreement with the earlier decision. Since the only direct taxes were "capitation taxes . . . and taxes on real estate,"¹¹⁰ and since an income tax was neither a capitation tax nor a tax on land, there was no necessity for apportionment.

III.

With the election of Cleveland in 1892 on a low tariff platform, his inauguration in 1893 when the country was on the verge of a financial panic, and with government expenses greatly increased, the Democrats sought a solution to their fiscal problems.¹¹¹

On the basis of the opinions of the members of the constitutional convention, the general understanding of the public, the subsequent conduct of Congress, and the unbroken line of judicial authority, no constitutional question seemed to be more completely settled than the power of Congress to tax income. Although bitterly attacked as a socialistic measure, a tax of two per cent of all income in excess of four thousand dollars was incorporated in the Wilson Tariff Act of 1894.¹¹²

Immediately thereafter Charles Pollock, of Massachusetts, filed a bill in equity against the Farmers' Loan & Trust Company to enjoin compliance with the income act. It was alleged that the defendant derived income from real estate and municipal bonds and from other sources, that the directors of the defendant had indicated an intention to pay the tax, and that such payment would result in the misapplication of corporate funds because there was no authority under the constitution for the collection of an unapportioned income tax. On demurrer the circuit court dismissed the bill, and appeal was taken to the Supreme Court. By

¹⁰⁷(1874) 23 Wall. (U.S.) 331, 23 L. Ed. 99.

¹⁰⁸(1880) 102 U. S. 586, 26 L. Ed. 253.

¹⁰⁹*Hylton v. United States*, (1796) 3 Dall. (U.S.) 171, 1 L. Ed. 335.

¹¹⁰(1880) 102 U. S. 586, 602, 26 L. Ed. 253.

¹¹¹See Blakey, *The Federal Income Tax* (1940) 12-17. See also Howe, *The Federal Revenues and the Income Tax* (1894) 4 *Annals of the American Academy of Political Science* 557.

¹¹²(1894) 28 Stat. at L. 509.

a six-to-two vote the decision of the lower court was reversed.¹¹³

In its opinion the Court took the position that the *Hylton Case* merely held that the tax on carriages could be sustained as an excise.

"It will be perceived that each of the justices, while suggesting doubt whether anything but a capitation or a land tax was a direct tax within the meaning of the constitution, distinctly avoided expressing an opinion upon that question or laying down a comprehensive definition, but confined his opinion to the case before the court."¹¹⁴

The Court then proceeded to brush aside the *Springer Case* by pointing out that the action in that case was one of ejectment by the holder of a tax title acquired as the result of the sale of Springer's land for taxes and that such title was valid if any part of the tax giving rise to the sale could be sustained. Since part of Springer's income had been derived from professional services, the tax on such income could be justified as an excise.¹¹⁵

Since "it is conceded in all of these cases, from that of *Hylton* to that of *Springer*, that taxes on land are direct taxes" and that since the Court was "unable to perceive any ground for the alleged distinction" between a tax on land and a tax on the "profits thereof," it was of the opinion that "the law in question, so far as it levies a tax on the rents or income from real estate, is in violation of the constitution, and is invalid."¹¹⁶ (On rehearing, by a five-to-four decision, the principle was extended to include income from personal property.)¹¹⁷

The Court then briefly distinguished *Pacific Insurance Co. v. Soule*¹¹⁸ and *Railroad Company v. Collector*.¹¹⁹ The Court said that the tax in the *Soule Case*

"Was sustained on the ground that it was 'a duty or excise,' . . . the decision turned on the distinction between an excise

¹¹³(1895) 157 U. S. 429, 15 Sup. Ct. 673, 39 L. Ed. 759; on rehearing, (1895) 158 U. S. 601, 15 Sup. Ct. 912, 39 L. Ed. 1108.

¹¹⁴(1895) 157 U. S. 429, 571, 572, 15 Sup. Ct. 673, 686, 39 L. Ed. 759.

¹¹⁵157 U. S. 429, 578-581, 15 Sup. Ct. 673, 688, 689, 39 L. Ed. 759.

¹¹⁶(1895) 157 U. S. 429, 579, 583, 15 Sup. Ct. 673, 689, 690, 39 L. Ed. 759.

¹¹⁷*Pollock v. Farmers' Loan & Trust Co.*, (1895) 158 U. S. 601, 15 Sup. Ct. 912, 39 L. Ed. 1108. The Court failed to mention in either decision the case of *Collector v. Day*, (1863) 1 Wall. (U.S.) 1, 17 L. Ed. 515 where it was said that "Congress possesses the power to collect and lay taxes, duties, imposts, and excises, and it is as competent for Congress to tax annual gains and profits before they are divided among the holders of the stock as afterwards, . . . Annual gains and profits, whether divided or not, are property, and, therefore, are taxable."

¹¹⁸(1869) 7 Wall. (U.S.) 433, 19 L. Ed. 95.

¹¹⁹(1879) 100 U. S. 595, 25 L. Ed. 647.

duty and a tax . . . regarding the former a charge for a privilege, or on the transaction of a business, without any necessary reference to the amount of property belonging to those on whom the charge might fall."¹²⁰

In *Railroad Company v. Collector* the Court said that the tax on the interest payments of a corporation on its bonds had been held to be "essentially an excise on the business of the class of corporations mentioned in the statute."¹²¹ However, an examination of the statute involved in the two latter cases clearly indicates that they were a part of the tax on personal incomes. Except for banks, insurance companies and certain transportation companies, the individual taxpayer was required to report as income the entire profits of the corporations in which he had stock—regardless of whether or not such profits were distributed. In the case of banks, insurance and transportation companies a different method of taxing the individual was employed. The tax was collected at the source, and the corporation was authorized to deduct the tax from the amount of the dividend or interest payment.¹²² The shareholder or bondholder, having paid the tax at the source, was not required to pay it again; consequently, the interest and dividends received from such corporations were deductible from gross income.¹²³ Since the corporation was permitted to deduct the tax from the amounts due stockholders and creditors, it is evident that the tax was not imposed upon the corporation.¹²⁴

¹²⁰(1895) 157 U. S. 429, 576, 15 Sup. Ct. 673, 687, 39 L. Ed. 759.

¹²¹The opinion intimated that the Court deciding the case had not given the question much thought since the justice writing the opinion had remarked that "the sum involved in this suit is small. . . the law . . . long since repealed" and that "the case is of little consequence as regards any principle involved in it as a rule of future action." (1895) 157 U. S. 429, 578, 15 Sup. Ct. 673, 688, 39 L. Ed. 759.

¹²²The *Soule* case involved sec. 120 and *Collector v. Railroad Company* sec. 122 of the 1864 income tax act. (13 Stat. at L. 223). Section 120 provided for a "duty of five percentum on all dividends . . . payable . . . to stockholders . . . [of banks and insurance companies] . . . and all undistributed sums . . . added during the year to their surplus." Section 122 applied to certain types of transportation companies and, in addition to the tax on dividends as required by sec. 120, required the payment of a tax on the interest paid by such corporations on their indebtedness. In both sections there were provisions authorizing the corporations "to deduct and withhold from all payments on account of any dividends (and interest in sec. 122) . . . the said tax of five percentum." Section 117 provided that the dividends of such corporations upon which the tax had been duly paid should be deducted from the taxpayer's income.

¹²³This deduction was omitted in the Act of 1865. 13 Stat. at L. 469, 479.

¹²⁴This was recognized in *United States v. Railroad Company*, (1873) 17 Wall. (U.S.) 322, 327, 21 L. Ed. 597, where the Court held the tax invalid when laid on the interest paid by the railroad to the City of Baltimore. Since the tax was "in substance and in law a tax upon the income of the creditor" it could not be applied to a municipal corporation which

Both in form and in substance the Civil War Act and the Act of 1894 were excise taxes or they were income taxes. The *Soule*, *Collector* and *Pollock Cases* all involved corporate taxpayers, yet in the first two decisions the tax was sustained as an excise, while in the third the statute was held invalid because it was an unapportioned tax on the income of a corporation derived from real and personal property and, therefore, "in substance" a tax on such corporate property. If the Court could distinguish an excise tax from an excise tax by calling one an income and the other an excise tax and thus hold one invalid and the other valid, there was some basis for the suspicion that Congress could do the same thing.

IV.

On June 13, 1898 Congress passed an act to provide ways and means to meet the expenditures of the Spanish-American War.¹²⁵ Among the taxes included therein was a duty on "legacies and distributive shares of personal property." The tax was sustained in *Knowlton v. Moore*¹²⁶ by a court which was made up of seven of the nine justices who had decided the *Pollock Cases*.¹²⁷

was not the subject of taxation by Congress. This had been recognized by Mr. Justice Field in his dissenting opinion in *United States v. Erie Railway Co.*, (1882) 106 U. S. 327, 331, 1 Sup. Ct. 223, 27 L. Ed. 151. "The company is thus made the agent of the government for the collection of the tax. It pays nothing itself; the tax is exacted from the creditor." Cf. *Bailey v. New York Central & H. R. R. Co.*, (1882) 106 U. S. 109, 116, 1 Sup. Ct. 62, 68, 27 L. Ed. 81; *Memphis & C. R. Co. v. United States*, (1883) 108 U. S. 228, 2 Sup. Ct. 482, 27 L. Ed. 711; *Sioux City & P. R. Co. v. United States* (1884) 110 U. S. 205, 3 Sup. Ct. 565, 28 L. Ed. 120. "The amount withheld by corporations from the dividends of shareholders should be allowed as a deduction since the tax is in reality a tax upon the shareholder and its payment by the corporation is merely a mode of collecting it." (1870) 10 Int. Rev. Rec. 9, Bump, Internal Rev. Laws 292. But even if it is assumed that the tax was on the corporation rather than a tax on the shareholder, there is nothing in the statute to indicate that Congress did not intend to lay an *income* tax on such corporation. Sections 120 and 122 fall under the subtitle INCOME in the Act of 1864 and are between the sections pertaining to personal incomes generally and the section taxing government officials and employees. Furthermore, with the exception of the rate, the language of the earlier act laying "a duty of five percentum on all dividends . . . and . . . sums added to the surplus" is very much the same as that of the 1894 Act providing for "a tax of two percentum . . . on the net profits . . . of . . . all corporations." It is not to be supposed that the use of the word "tax" in one act and the word "duty" in the other influenced the Court's determination that the later act was unconstitutional as an *income* tax while the earlier act was valid as an *excise*. Cf. *Graves, Inherent Improprieties in the Income Tax Amendment to the Federal Constitution*, (1910) 19 Yale L. J. 505, 507.

¹²⁵(1898) 20 Stat. at L. 448.

¹²⁶(1900) 178 U. S. 41, 20 Sup. Ct. 747, 44 L. Ed. 969.

¹²⁷Field and Jackson had been replaced by Peckham and McKenna.

Although the case was decided by a five-to-three vote,¹²⁸ two of the dissents involved a question of statutory interpretation, while the third objected only to the progressive rate provision. Mr. Justice White, in delivering the opinion of the Court, pointed out that "death duties, generally, have been from the beginning of all countries considered as different from taxes levied on property;" the *Pollock Case* did not require the application of the economist's test of shiftability in determining whether a tax was direct or indirect, it did not overrule *Scholey v. Rew*,¹²⁹ and therefore, "the tax under consideration was not direct under the constitution."¹³⁰

In *Spreckles Sugar Refining Company v. McClain*¹³¹ the court sustained a tax of one-fourth of one per cent on the gross receipts of a sugar refinery in excess of \$250,000 saying that

"Clearly the tax is not imposed upon gross annual receipts as property, but only in respect of the carrying on or doing the business of refining sugar. It cannot be otherwise regarded because of the fact that the amount of the tax is measured by the amount of the gross annual receipts. The tax is defined in the act as 'a special excise tax,' and, therefore it must be assumed, for what it is worth, that Congress has no purpose to exceed its powers under the Constitution, but only to exercise the authority granted to it of laying and collecting excises."

During the same term the tax on the sale of stock by brokers was sustained in *Thomas v. United States*.¹³² The Court pointed out that "taxes of this sort have been repeatedly sustained . . . and distinguished from direct taxes" citing, among others, the *Hylton Case*,¹³³ *Nicol v. Ames*,¹³⁴ which sustained the federal tax on sales at exchanges or boards of trade, and *Treat v. White*,¹³⁵ which permitted a tax on "call" sales of shares of stock by brokers. The latter two cases were decided after *Pollock v. Farmers' Loan & Trust Co.*, and were thought to be in no way inconsistent with the holding in that case.

In *Patton v. Brady*¹³⁶ a second "excise" tax on tobacco was said to be a "tax on the article manufactured for consumption" and that "it is within the power of Congress to increase an excise, as well as a property tax, at least while the property is held for

¹²⁸Peckham, J., took no part in the decision.

¹²⁹Supra, page 436.

¹³⁰(1900) 178 U. S. 41, 78-83, 20 Sup. Ct. 747, 44 L. Ed. 969.

¹³¹(1904) 192 U. S. 397, 411, 24 Sup. Ct. 376, 380, 48 L. Ed. 496.

¹³²(1904) 192 U. S. 363, 24 Sup. Ct. 305, 48 L. Ed. 481.

¹³³(1796) 3 Dall. (U.S.) 171, 1 L. Ed. 536.

¹³⁴(1898) 173 U. S. 509, 19 Sup. Ct. 522, 43 L. Ed. 786.

¹³⁵(1901) 181 U. S. 264, 21 Sup. Ct. 611, 45 L. Ed. 853.

¹³⁶(1902) 184 U. S. 608, 623, 22 Sup. Ct. 493, 499, 46 L. Ed. 713.

sale." But any uncertainty as to the power to tax property even in the hands of the consumer had been settled in 1796, and any doubt as to the status of the *Hylton Case* resulting from the *Pollock* decision was set at rest by *Billings v. United States*¹³⁷ where the Court held that a tax on foreign-built yachts was a proper exercise of the federal taxing power.

Although the *Pollock Case* provoked considerable litigation during the years immediately following its decision, it did not prevent Congress from exercising its power to enact those usual and customary taxes which had their inception in the acts of 1791 and 1794.¹³⁸ Congress was permitted to tax personal property before the *Pollock Case*, and the decisions thereafter indicated no tendency to deprive Congress of a large part of its taxing power. A tax on carriages was sustained in 1793, and a tax on foreign-built yachts sustained in 1914. The suggestion in the *Hylton* opinion that a tax on personal property was not a direct tax within the meaning of the constitution found its strongest support in *Patton v. Brady*, decided in 1902. If Congress may lay a recurring "excise" tax on property,¹³⁹ any substantial difference between the two types of taxes, so far as any constitutional question is concerned, is non-existent. The *Pollock* decision, because of the Court's subsequent refusal to consider matters of substance, gave rise to the anomalous doctrine that, in effect, Congress could tax personal property, but could not tax the income from personal property. A tax on the income from property was equivalent to a tax on property, and was invalid unless apportioned; but a recurring "excise" tax on property was not equivalent to a tax on property. As was said in the *Nicol Case*, the tax was not to be "upon the business itself which is so transacted, but it is a duty upon the facilities made use of and actually employed in the transaction of business."¹⁴⁰ In *Spreckles Sugar Refining Co. v. McClain*, it was not the gross receipts which were taxed, the tax was "only in respect of the carrying on or

¹³⁷(1914) 232 U. S. 261, 34 Sup. Ct. 421, 58 L. Ed. 596.

¹³⁸"The decisions of the Supreme Court may fall like thunderbolts from Almighty Jove. There is a blinding flash, perhaps some spectacular damage to a restricted area. Temporarily there is terror and repentance. But soon calm is resumed and with it confidence that, granted a proper observance of prescribed rituals and occasional adaptation of their form to the whims of an angry god, there is likely to be very little interference with the actual plans of those who walk the earth below." Foster, *Conflicting Ideals for Reorganization*, (1935) 44 Yale L. J. 923, 927, 928.

¹³⁹The tax in *Billings v. United States*, (1914) 232 U. S. 261, 34 Sup. Ct. 421, 58 L. Ed. 596, was an annual tax.

¹⁴⁰(1898) 173 U. S. 509, 519, 19 Sup. Ct. 522, 527, 43 L. Ed. 786.

doing business of refining sugar."¹⁴¹ And in *Knowlton v. Moore* the Court was careful to say that the tax did not relate "to property eo nomine," but only "to its passage by will or . . . intestacy."¹⁴²

Thus the second *Pollock* decision, which expanded "direct taxes" to include personal as well as real property, required only that a tax on personal property be given a name other than that of a personal property tax. The difference between a direct tax on personal property and an indirect tax was nothing more than a matter of form—its constitutionality was to be determined by its label and not by its effect.

V.

Because of the political, economic and personal elements which surrounded the enactment and invalidation of the Act of 1894, there was deep resentment and disappointment on the part of those who saw in the income tax a more satisfactory method of raising revenue.¹⁴³ Many believed that all matters deserving of consideration had not been brought to the attention of the Court, and that a properly drafted statute would meet the constitutional objection of the *Pollock Case*. Judge Taft, in his speech accepting the nomination for the presidency, said that "I believe that an income tax . . . can and should be devised which, under the decisions of the Supreme Court, will conform to the constitution."¹⁴⁴

During the Special Session of 1909 there was a strong drive for the enactment of a personal and corporate income tax substantially identical with that of the Act of 1894.¹⁴⁵ However, President Taft forestalled this attempt. In a message to Congress on June 6, 1909, the president recommended first, a tax on cor-

¹⁴¹(1904) 192 U. S. 397, 411, 24 Sup. Ct. 376, 380, 48 L. Ed. 481. The distinctions between direct taxes and excises were said to be "often very difficult to be expressed in words." (1904) 192 U. S. 397, 413, 24 Sup. Ct. 305, 281, 48 L. Ed. 481.

¹⁴²(1900) 178 U. S. 41, 47, 20 Sup. Ct. 747, 750, 44 L. Ed. 969.

¹⁴³"It is not easy to find another decision which so openly departs from the law in order to shelter privilege." Bascom, *Growth of Nationality in the United States*. For a general discussion of the background of the Corporation Excise Tax of 1909 and the sixteenth amendment see Blakey, *The Federal Income Tax* (1940) ch. 2. See also, Bizzell, *Judicial Interpretation of Political Theory* (1914) ch. 9.

¹⁴⁴N. Y. Daily Tribune, July 29, 1908. For an earlier, but unfavorable statement of the current view see West, *The Income Tax and the National Revenues*, (1900) 8 J. Pol. Econ. 433. Cf. Borah, *Income Tax Sound in Law and Economics*, (1910) 10 Journal of Accountancy 26.

¹⁴⁵See Blakey, *The Federal Income Tax* (1940) ch. 2; Anderson, *The Problem of Tax-Exempt Securities* (1924) 8 MINNESOTA LAW REVIEW 273, 278.

porations measured by annual income and second, a constitutional amendment which would give the federal government "the power to levy an income tax without apportionment among the states in proportion to population." The amendment was recommended because

"this course is much to be preferred to the one proposed of re-enacting a law once judicially declared to be unconstitutional. For Congress to assume that the Court will reverse itself, and to enact legislation on such an assumption will not strengthen popular confidence in the stability of judicial construction of the constitution."¹⁴⁶

In the interest of harmony, a compromise was reached and the Corporation Excise Tax of 1909 became law.¹⁴⁷

Since only two of the justices¹⁴⁸ who decided the *Pollock Cases* were still on the bench when the validity of the Corporation Excise Tax came before the Court, and since these two members had registered the only dissent in the first case and wrote two of the four strong dissenting opinions¹⁴⁹ in the second decision, it was not surprising that the tax was sustained.¹⁵⁰ However, instead of overruling the *Pollock* decision the Court solemnly distinguished the two taxes. Evidently the president's warning about destroying public confidence was taken to heart, because the Court discovered that the "difference between the acts is not merely nominal, but rests upon substantial differences between the mere ownership of property and the actual doing of business in a certain way."¹⁵¹

The Act of 1894¹⁵² laid a tax "on the net profits of all corporations," while the 1909 Act¹⁵³ provided that "every corporation . . . shall be subject to pay annually a special excise tax with respect to the carrying on or doing business . . . equivalent to one percentum upon the entire net income." Except for the difference

¹⁴⁶15 Messages and Papers of the Presidents 7390. Cf. *Pennoyer, The Income Tax Decision, and the Power of the Supreme Court to Nullify Acts of Congress*, (1895) 29 Am. L. Rev. 550, 590.

¹⁴⁷(1909) 36 Stat. at L. 11.

¹⁴⁸White and Harlan, JJ.

¹⁴⁹Brown, J. and Jackson, J. also wrote separate dissenting opinions.

¹⁵⁰*Flint v. Stone Tracy Co.*, (1911) 220 U. S. 107, 31 Sup. Ct. 343, 55 L. Ed. 389. The opinion was written by Day, J. for a unanimous Court. Cf. *Eliot v. Freeman*, (1911) 220 U. S. 178, 31 Sup. Ct. 360, 55 L. Ed. 424; *Zonne v. Minneapolis Syndicate*, (1911) 220 U. S. 187, 31 Sup. Ct. 361, 55 L. Ed. 428; *McCoach v. Minehill & S. H. R. Co.*, (1913) 228 U. S. 295, 33 Sup. Ct. 419, 57 L. Ed. 842.

¹⁵¹(1911) 220 U. S. 107, 150, 31 Sup. Ct. 343, 349, 55 L. Ed. 389.

¹⁵²(1894) 28 Stat. at L. 509.

¹⁵³(1909) 36 Stat. at L. 11.

in language, it is difficult to discover any other distinguishing characteristic. Both statutes taxed corporations, in both the amount of the tax was determined by the income of the taxpayer, and in both the income included profits from land and from tangible and intangible personal property—including interest from tax exempt securities. Perhaps the “substantial difference” was found in the fact that in the Act of 1894 Congress called an income tax an income tax, but in the Act of 1909 Congress called an income tax an excise. Whatever the difference may have been, it was sufficient to sustain the validity of the tax. There was no need to lose “popular confidence” by overruling an unpopular decision so long as a tenuous distinction could be used to obtain the same result—or, at least, to obtain that which at the time seemed to be the same result.

VI.

Immediately following the adoption of the sixteenth amendment, the Court showed a disposition to consider the income tax as an excise. In *Stanton v. Baltic Mining Co.*,¹⁵⁴ the Court had occasion to pass upon the validity of the depletion provision of the 1913 Act. The deduction was limited to five per cent of the gross value of the output of the mine, and it was objected that the January 1, 1909 value of the capital represented by the ores extracted during the year greatly exceeded the five per cent deduction permitted by the statute. Accordingly it was argued that to the extent that actual depletion (based on January 1, 1909 value) exceeded allowed depletion such excess represented a return of capital and being capital, Congress could not subject it to an unapportioned tax.

The Court, however, sustained the arbitrary five per cent depletion limitation. Mr. Chief Justice White, who had dissented in both of the *Pollock Cases*, observed that the purpose of the sixteenth amendment was to prevent the Court from taking income taxes out of the

“category of indirect taxation to which it inherently belonged, and being placed in the category of direct taxation subject to apportionment by a consideration of the sources from which the income was derived—that is, by testing the tax not by what it was, a tax on income, but by a mistaken theory deduced from the origin of source of the income taxed.”¹⁵⁵

The Chief Justice then concluded that

¹⁵⁴(1916) 240 U. S. 103, 36 Sup. Ct. 278, 60 L. Ed. 546.

¹⁵⁵(1916) 240 U. S. 103, 112, 113, 36 Sup. Ct. 278, 281, 60 L. Ed. 546.

"independently of the effect of the operation of the sixteenth amendment it was settled in *Stratton's Independence v. Howbert*, 231 U. S. 399, that such a tax is not a tax upon property as such because of its ownership, but a true excise levied on the results of the business of carrying on mining operations."¹⁵⁶

The Court was clearly of the opinion that the tax in question could be sustained as an excise. The taxpayer was engaged in business and a tax could be laid upon such activity. The fact that the word "income" had been used to describe the tax did not prevent the Court from considering it in the light of a permissible excise. As had been said in *Brushaber v. Union Pacific R. R. Co.*¹⁵⁷ decided earlier in the same term,

"the *Pollock Case* . . . recognized the fact that taxation on income was in its nature an excise entitled to be enforced as such unless and until it was concluded that to enforce it would amount to accomplishing the result which the requirement as to apportionment of direct taxation was adopted to prevent."¹⁵⁸

The sixteenth amendment

"does not purport to confer power to levy income taxes in a generic sense,—an authority already possessed . . . the whole purpose of the Amendment was to relieve all income taxes when imposed from apportionment from a consideration of the source whence the income was derived."¹⁵⁹

If the income tax was to be considered as an excise, then it was not necessary to look to the measure of the tax. As in all excises, if the tax were levied upon the proper subject, no constitutional problem could successfully be raised as to its measure—at least so long as the measure bore some reasonable relationship to the subject being taxed. The *Pollock Case* had warped the excise on incomes into a direct tax, but the sixteenth amendment had restored it to its former shape. Therefore, the Court in the *Stanton Case* could accept the taxpayer's assumption that the tax in question was a tax, in part, upon capital. That made no difference. An income tax was an excise and not "direct," and it could be measured by capital. The failure to detect this was "the obvious error of the proposition intrinsically considered" when it was argued by the taxpayer that the tax was on the gross product of the mine, that it was a direct tax and therefore was void for want of apportionment.¹⁶⁰

¹⁵⁶(1916) 240 U. S. 103, 114, 36 Sup. Ct. 278, 281, 60 L. Ed. 493.

¹⁵⁷(1916) 240 U. S. 1, 36 Sup. Ct. 236, 60 L. Ed. 493.

¹⁵⁸(1916) 240 U. S. 1, 16, 17, 36 Sup. Ct. 236, 241, 60 L. Ed. 493.

¹⁵⁹(1916) 240 U. S. 1, 17, 18, 36 Sup. Ct. 236, 241, 60 L. Ed. 493.

¹⁶⁰(1916) 240 U. S. 103, 112, 36 Sup. Ct. 278, 281, 60 L. Ed. 493.

But even if this were not true, the taxation of the product of a mine was not a direct tax on such product, but was an excise levied on the results of "the business of carrying on mining operations." A tax on capital had been sustained as an excise in *Stratton's Independence v. Howbert*,¹⁶¹ and the act of 1913 could be sustained in the same manner. As had been said in the *Howbert Case*

"Congress, in exercising the right to tax a legitimate subject of taxation as a franchise or privilege, was not debarred by the constitution from measuring the taxation by the total income, although derived in part from property which, considered by itself, was not taxable. It was reasonable that Congress should fix upon gross income, without distinction as to source, as a convenient and sufficiently accurate index of the importance of the business transacted."¹⁶²

The companion case to *Stanton v. Baltic Mining Co., Tyee Realty Co. v. Anderson*,¹⁶³ involved the limitation on the deduction of interest expense. It was argued that the denial of the full deduction for interest paid resulted in the taxation of something more than "income in the true sense of the word." The argument was ignored by the Court, as it had been in the *Brushaber Case*,¹⁶⁴ and the tax sustained.

It thus seems clear that in 1916 the Supreme Court fully accepted the income tax as an excise tax and refused to consider any questions relating to the measure of the tax.¹⁶⁵ If this had not been amply demonstrated by the *Brushaber* and *Stanton Cases*, it was clearly indicated by the holding in the *Tyee* decision. It may be argued that the *Brushaber Case* merely rejected a blanket objection to the 1913 Act; and that the *Stanton Case* may be rationalized on the ground that Congress was taxing income as that word was commonly understood at the time of the adoption of the sixteenth amendment.¹⁶⁶ But interest payments have been gen-

¹⁶¹(1913) 231 U. S. 399, 34 Sup. Ct. 136, 58 L. Ed. 285.

¹⁶²(1913) 231 U. S. 399, 416, 417, 34 Sup. Ct. 136, 142, 58 L. Ed. 285.

¹⁶³(1916) 240 U. S. 115, 36 Sup. Ct. 281, 60 L. Ed. 554.

¹⁶⁴This argument was one of the many "minute" and "hypercritical" contentions made by the taxpayer. (1916) 240 U. S. 1, 24, 36 Sup. Ct. 236, 244, 60 L. Ed. 493.

¹⁶⁵The amendment was drawn for the purpose of doing away for the future with the principle upon which the *Pollock Case* was decided." *Brushaber v. Union Pacific R. Co.*, (1916) 240 U. S. 1, 36 Sup. Ct. 236, 60 L. Ed. 493.

¹⁶⁶"Until the passage of the sixteenth amendment to the constitution of the United States, under which an income tax could be levied on individuals and corporations, it was usual for mining companies to carry their properties at the sum of the amount of the stock issued for properties thus acquired plus the cash paid for subsequent additions. Provision for exhaus-

erally regarded as an expense which must be deducted from receipts in order to determine income. The inclusion of this expense could not be sustained as being within the "common understanding of the meaning of the word."

Within less than three years after the adoption of the sixteenth amendment the Supreme Court apparently accepted the principle that in taxing income Congress was not limited to *net* income. The Court further intimated that it would not concern itself too greatly with the measure of the tax. Such problems were put to rest when the amendment restored the income tax to the "category of indirect taxation to which it inherently belonged."

VII.

Unfortunately the restoration was only temporary. The *Pollock* decision had made two radical changes in the federal taxing power. First, it broadened the concept of a direct tax from that of an ordinary tax on realty to a tax which included all property. Second, it introduced the doctrine that a tax on the income from property was substantially a tax on the property itself and was invalid unless apportioned.

When President Taft insisted upon a constitutional amendment instead of a reversal of *Pollock v. Farmers' Loan & Trust Co.*, and when the Supreme Court gave no indication in *Flint v. Stone Tracy Co.* that an amendment was not necessary, a number of constitutional questions were unnecessarily created.

The sixteenth amendment gave Congress the power to "lay and collect taxes on incomes, from whatever source derived, without apportionment." Its immediate purpose was to remove the second limitation upon the federal taxing power which had been introduced by the *Pollock Case*. No mention was made of the first limitation, and consequently it was impossible to ascertain from the letter of the amendment whether the *Hylton* interpretation or the *Pollock* interpretation of "direct taxes" was to be followed in the future. Yet the fact that an income tax had been secured through an amendment to the constitution rather than by the simpler expedient of a legislative reenactment of the 1894 Act may have been significant. At least the Court in *Brushaber v. Union Pacific R. R. Co.*¹⁶⁷ appeared to think that the amend-

tion or depletion of mining properties in the financial accounts was rare." Peloubet, *Natural Resources Assets—Their Treatment in Accounts and Valuation*, (1937) 16 Harv. Bus. Rev. 74, 75-76.

¹⁶⁷(1916) 240 U. S. 1, 36 Sup. Ct. 236, 60 L. Ed. 493.

ment had an indirect effect upon the first point involved in the *Pollock* decision.

"... it is to be observed that although from the date of the *Hylton Case*, because of the statements made in the opinions in that case, it had come to be accepted that direct taxes in the constitutional sense were confined to taxes levied directly on real estate because of its ownership, the amendment contains nothing repudiating or challenging the ruling in the *Pollock Case* that the word 'direct' had a broader significance, since it embraced also taxes levied directly on personal property because of its ownership, and therefore the amendment at least impliedly makes such wider significance a part of the constitution,—a condition which clearly demonstrates that the purpose was not to change the existing interpretation. . . ."¹⁶⁸

If the amendment incorporated the doctrine of the *Pollock Case* into the constitution with respect to the first limitation, it was entirely possible that the Court would make the coalescence complete by attributing to any tax designated by Congress as an "income tax" all of the qualities of a direct tax. That is, if an income tax laid on income from property was essentially a direct tax, a fortiori an income tax laid on property itself was a direct tax. The sixteenth amendment removed the requirement of apportionment of an income tax which taxed income, but it in no way mentioned an income tax which taxed property. Although the Court had frequently sustained taxes on property after the *Pollock* decision, these taxes were in the form of excises; any attempt to tax the same property by an income tax would inevitably meet the objection that it was a direct tax and void because not apportioned. As has been seen, this objection was made and rejected in the *Brushaber*, *Stanton* and *Tyee Cases*. Unfortunately, these decisions were not taken very seriously. The lasting effect of the *Pollock* decision in linking the income tax with the direct tax clause of the constitution was more than enough to overcome the rationale of those cases.

In *Towne v. Eisner*¹⁶⁹ the taxpayer brought an action to recover income taxes paid upon stock dividends. Augustus N. Hand, District Judge, prefaced his remarks as follows:

"Gains and profits from business can only be taxed under the present Income Tax Act by virtue of ownership of the property from which they are derived. They are not, like excise taxes, based upon the earnings of a business, corporate or otherwise. They are direct taxes, under the decision of the Supreme Court

¹⁶⁸(1916) 240 U. S. 1, 19, 36 Sup. Ct. 236, 242, 60 L. Ed. 493.

¹⁶⁹(S.D. N.Y. 1917) 242 Fed. 702.

in *Pollock v. Farmers' Loan & Trust Co.*, and would have to be apportioned, but for the recent enactment of the sixteenth amendment to the constitution. . . . Now it is manifest that the stock dividend in question cannot be reached by the Income Tax Act, and could not, even though Congress expressly declared it to be taxable as income, unless it is in fact income."¹⁷⁰

However, his remarks were unnecessary to the decision, since it was decided that stock dividends "possess the real essentials of income" and the tax was, therefore, constitutional.

When the case reached the Supreme Court it was reversed.¹⁷¹ Mr. Justice Holmes, speaking for the Court, said that "we cannot doubt that the dividend was capital . . . for the purposes of the Income Tax Law. . . ."¹⁷²

Unlike the 1913 Act,¹⁷³ which was before the Court in *Towne v. Eisner*, the 1916 Act¹⁷⁴ contained an express provision laying a tax on stock dividends.¹⁷⁵ When the taxpayer brought an action to recover taxes paid on a stock dividend, the same district court which had decided the *Towne Case* held the statute unconstitutional. The Supreme Court, in a five-to-four decision, affirmed the judgment below.¹⁷⁶

Mr. Justice Pitney, writing the opinion for the Court, accepted the premise of the *Pollock Case* that

"taxes upon rents and profits of real estate and upon returns from investments of personal property were in effect direct taxes . . . and that Congress could not impose such taxes without apportioning them. . . ."¹⁷⁷

The sixteenth amendment merely removed the necessity which otherwise might exist for an apportionment among the states of taxes laid on income. In order that the apportionment requirement be given

"proper force and effect, save only as modified by the amendment, and that the latter also may have proper effect, it becomes essential to distinguish between what is and what is not 'income,' as the term is there used, and to apply the distinction, as cases arise, according to truth and substance, without regard to form."¹⁷⁸

¹⁷⁰(S.D. N.Y. 1917) 242 Fed. 702, 704.

¹⁷¹*Towne v. Eisner*, (1918) 245 U. S. 418, 38 Sup. Ct. 158, 62 L. Ed. 372.

¹⁷²(1918) 245 U. S. 418, 426, 38 Sup. Ct. 158, 159, 62 L. Ed. 372.

¹⁷³(1913) 38 Stat. at L. 166.

¹⁷⁴(1916) 39 Stat. at L. 756.

¹⁷⁵Sec. 2(a).

¹⁷⁶*Eisner v. Macomber*, (1920) 252 U. S. 189, 40 Sup. Ct. 189, 64 L. Ed. 521.

¹⁷⁷(1920) 252 U. S. 189, 205, 40 Sup. Ct. 189, 192, 64 L. Ed. 521.

¹⁷⁸252 U. S. 189, 206, 40 Sup. Ct. 189, 193, 64 L. Ed. 521.

Thus the association of the income tax with the direct tax continued after the amendment. To Mr. Justice Pitney the income tax remained essentially a direct tax relieved of the necessity of apportionment only so far as the tax fell literally within the language of the amendment—and the *Stanton* and *Brushaber Cases* were cited as authority for this view!

The reference to "truth and substance" in connection with a controversy over whether the tax was direct or indirect clearly indicated the decision of the Court. As early as the *Hyllton Case* it had been recognized that "some taxes may be both direct and indirect at the same time" and still valid as excises.¹⁷⁰ Few taxes could be sustained as excises if the Court should insist on matters of substance. As Mr. Justice Holmes tersely remarked in his dissent: "The known purpose of the amendment was to get rid of nice questions as to what might be direct taxes."¹⁸⁰

The failure to appraise correctly the force of the term "income" was said to be a "fundamental error" on the part of the government.¹⁸¹ *An income tax could not be used to tax that which was not income.* Yet in the *Stanton Case* the "obvious error" of the taxpayer was the proposition that *an income tax could not be used to tax that which was not income.*¹⁸² The situation was made more obscure by the fact that the Chief Justice wrote the opinion in the *Stanton Case* and agreed with the majority in the *Macomber* decision. The earlier opinion related exclusively to the consideration of *excise* taxes; the later decision made no mention of them. Within a period of three years the attitude of the Court had changed entirely. "Fundamentally," an income tax had again changed from an excise to a direct tax.¹⁸³

By 1924 the philosophy of the *Pollock* and *Macomber Cases* had become so thoroughly established that the Court, in *Edwards v. Cuba Railroad Co.*¹⁸⁴ held that subsidies paid from 1911 to 1916

¹⁷⁰(1796) 3 Dall. (U.S.) 171, 174, 1 L. Ed. 556.

¹⁸⁰(1920) 252 U. S. 189, 220, 40 Sup. Ct. 189, 197, 198, 64 L. Ed. 521.

¹⁸¹(1920) 252 U. S. 189, 213, 40 Sup. Ct. 189, 195, 64 L. Ed. 521.

¹⁸²See *supra*, page 445.

¹⁸³Following *Eisner v. Macomber*, (1920) 252 U. S. 189, 40 Sup. Ct. 189, 64 L. Ed. 521, the lower federal courts emphasized the distinction between an income tax and an excise. For example, in *United States v. Philadelphia B. & W. R. Co.*, (E.D. Pa. 1920) 262 Fed. 188, 190, it was said that "There is, of course, a fundamental difference between an income tax and an excise tax . . . An income tax . . . is a direct tax imposed upon the thing called income, and is directly imposed as is a tax on land." See also, *Cadwalader v. Lederer*, (E.D. Pa. 1921) 273 Fed. 879 and *Brewster v. Walsh*, (D. Conn. 1920) 268 Fed. 207.

¹⁸⁴(1925) 268 U. S. 628, 633, 45 Sup. Ct. 614, 615, 69 L. Ed. 1124.

inclusive by the Republic of Cuba to a New Jersey corporation "were not profits or gains from the use or operation of the railroad, and do not constitute income within the meaning of the sixteenth amendment." Although the case could have been decided solely with reference to the meaning of the various income tax statutes under consideration, the Court rested its decision on the basis of unconstitutionality. If Congress should attempt to tax similar payments to corporations, the tax would have to be the result of the exercise of some power other than that provided by the sixteenth amendment. Congress did not intend to tax the subsidies under the 1909 Act and *could* not tax them under the sixteenth amendment income tax statutes. Any intention on the part of Congress to tax such payments in the future would have to be clearly expressed in an excise tax; it would be unconstitutional if contained in an income tax.

VIII.

Within ten years after the adoption of the sixteenth amendment the Supreme Court had established two lines of authority relating to the subject of taxable income.¹⁸⁵ One line, based on the idea that an income tax was an excise, permitted the taxation of capital. The other line of authority, based on the premise that the income tax was essentially a direct tax, denied Congress the right to tax capital. The first series of cases had arisen under the deduction provisions of the Act while the second had arisen under the provisions relating to inclusions in gross income; yet this should have made no difference in the result.¹⁸⁶ Income, the Court has frequently remarked, is a constitutional concept, and constitutional concepts are not defeated by mere matters of form.¹⁸⁷ If Congress may not tax capital in its pure state, it should not be permitted to tax capital when diluted with large

¹⁸⁵"In income tax legislation we have grown accustomed to thinking of gross income, on the one hand, and of deductions, on the other hand, as two rather distinct and separate groups of items. This custom has become so imbedded in our collective minds that it has induced us to accept as a fundamentally established principle of taxation, at least of Federal income taxation and in some degree of all income tax legislation, the familiar and oft repeated statement that the legislative bodies are restricted in providing what may be included in gross income but have complete and uncontrolled discretion in providing or failing to provide for the allowance of deductions." Walsh, *Actual Income Versus Taxable Income under the 1934 Act—Deductions*, (1935) 13 Tax Mag. 255, 256.

¹⁸⁶See Pitney, J., in *Doyle v. Mitchell Bros. Co.*, (1918) 247 U. S. 179, 188, 38 Sup. Ct. 467, 470, 62 L. Ed. 1054.

¹⁸⁷*Weiss v. Stearn*, (1924) 265 U. S. 242, 254, 44 Sup. Ct. 490, 492, 68 L. Ed. 1001.

quantities of income. If Congress may not include capital in gross income when it is unmixed with profits, it should be permitted to require the inclusion of an obvious mixture of income and capital in gross income only upon the condition that the mixture be sorted and the capital deducted from the aggregate. On the other hand, if Congress may tax capital by an unapportioned tax, then it should not matter whether the tax is in the form of an excise tax or in the form of an "income" tax—as long as the tax has substantially the same effect the form of the statute should not determine its constitutionality. But such was not the effect of the decisions of the Supreme Court.

When confronted with a problem involving deductions from gross income the courts had two alternatives. Deductions could properly be denied by Congress on the authority of the depletion cases, or they could be demanded as a matter of right by the taxpayer on the authority of the dividend cases. However, the selection of the alternative was not a difficult problem, since there were only a limited number of possible cases which could present clear instances of property taxation. Congress in the exercise of its power under the sixteenth amendment had been generous in its allowance of deductions from gross income,¹⁸⁸ and there were few opportunities for the courts to elaborate upon the direct tax concept of the income tax. At the same time it was inevitable that the deduction provisions would give rise to litigation. The necessity of distinguishing between capital and income would give the courts an opportunity to greatly expand or sharply limit the influence of the *Brushaber*, *Stanton* and *Tyee Cases*.

In *New Creek Co. v. Lederer*¹⁸⁹ the taxpayer argued that none of its royalties could be taxed as income until the 1913 value of such receipts had been recovered. The commissioner rejected the contention and prorated the 1913 value of the royalties over the estimated amount of ores in place on that date. Relying upon the 1909 excise and 1913 income tax-depletion cases the Court, in sustaining the Commissioner, said:

"Whatever right a corporate mine owning taxable had to deduct from the gross income of its mine anything for depreciation or depletion came to it solely by virtue of the statute under which the tax was assessed."¹⁹⁰

Shortly thereafter the same court, in *Ludington v. Mc-*

¹⁸⁸Magill, *Taxable Income* (1936) 393.

¹⁸⁹(C.C.A. 3d Cir. 1924) 295 Fed. 433.

¹⁹⁰(C.C.A. 3d Cir. 1924) 295 Fed. 433, 435.

Caughn,¹⁹¹ had occasion to determine the basis for computing the deductible loss resulting from the sale of stock. Since the Civil War income tax acts and those of 1894 and 1913 had made no provision for the deduction of such losses, it was assumed that there was no constitutional question involved. Therefore "Congress may allow or disallow them at will and upon any basis. Taxable gain is a constitutional concept . . . while deductible loss is a creation of Congress."¹⁹²

During the following year two additional cases contained language basically inconsistent with the direct tax theory of income taxes. In *Westerfield v. Rafferty*¹⁹³ a federal district court, in sustaining a tax on the "profits" from the sale of land without permitting the deduction of the carrying charges, emphasized the fact that "the tax and the method of arriving at it is purely statutory." And in *Kentucky Tobacco Products Co. v. Lucas*¹⁹⁴ another federal district court was even more emphatic. Although, as in the *Ludington Case*, its decision was in favor of the taxpayer, the Court remarked that

"Congress had the power to require the payment of the tax without allowing any deduction for the purpose of returning to the taxpayer his entire invested capital at the expiration of the life of the property from which the income was derived."¹⁹⁵

Some four years elapsed before there was again express mention of the statutory nature of income tax deductions.¹⁹⁶ In determining the amount of the deductible loss resulting from the sale of securities the Board of Tax Appeals said:

"As we interpret the power of Congress to levy an income tax, there is no requirement that Congress permit the deduction of every kind of loss that may be sustained by a taxpayer. The deduction of a loss from income received is purely a matter of grace."¹⁹⁷

¹⁹¹(C.C.A. 3d Cir. 1924) 1 F. (2d) 689.

¹⁹²(C.C.A. 3d Cir. 1924) 1 F. (2d) 689, 692.

¹⁹³(E.D. N.Y. 1925) 4 F. (2d) 590, 592.

¹⁹⁴(W.D. Ky. 1925) 5 F. (2d) 723.

¹⁹⁵(W.D. Ky. 1925) 5 F. (2d) 723, 728.

¹⁹⁶*Bloch v. Commissioner*, (1929) 16 B. T. A. 425.

¹⁹⁷(1929) 16 B. T. A. 425, 430. During the same year the circuit court of appeals for the second circuit in *American Can Co. v. Bowers*, (C.C.A. 2d Cir. 1929) 35 F. (2d) 832, 835, cert. denied, 281 U. S. 736, 50 Sup. Ct. 249, had occasion to reject a request for the use of an inventory based on "normal stocks" which had been adopted by the corporate taxpayer for the purpose of minimizing the fluctuations in its annual profits and losses resulting from violent price changes in its tin inventories. In emphasizing the statutory nature of the income tax the Court said: "Necessarily, net income, for tax purposes, is a conception of the income tax statute, and the amount arrived at is ascertained by deducting from the gross amount

During the ten years following *Eisner v. Macomber*¹⁹⁸ only a few cases contained statements which inherently accepted the excise concept of taxable income. Of the cases mentioned above, two involved the deduction of losses¹⁹⁹ and the remainder presented the problem of determining when²⁰⁰ a deduction could be taken. Yet even at this early period of development some of the courts indicated a tendency to use language broad enough to cover *all* deductions—as if there were no differences of degree or kind among them. Although infrequently cited, these cases used most of the various methods of expressing the idea that deductions are not required by the constitution. It is significant that the first of these cases cited *Stanton v. Baltic Mining Co.*,²⁰¹ a decision where the Supreme Court was “exclusively concerned with the nature of an income tax as essentially an excise.”²⁰²

In sharp contrast with the mild and carefully guarded statements made prior to 1930, the language used after that date relative to the power of Congress to limit or deny deductions from gross income became much more emphatic and inclusive. In *Phipps v. Bowers*²⁰³ a district court, in sustaining a provision denying the right to deduct interest on loans used to purchase tax-exempt securities, made this sweeping statement:

“That it is within the power of Congress to determine what deductions, if any, may be taken from gross income in arriving at net income, is not open to question unless the result be undue discrimination.”²⁰⁴

of income received by the taxpayer from all sources the specified deduction allowed to it by statute. For corporate purposes only, it may well be, on the other hand, that net income may be arrived at by the deduction of entries and accounts which are not permissible for the purpose of taxation.”

¹⁹⁸(1920) 252 U. S. 189, 40 Sup. Ct. 189, 64 L. Ed. 521.

¹⁹⁹*Ludington v. McCaughn*, (C.C.A. 3d Cir. 1924) 1 F. (2d) 689, and *Bloch v. Commissioner*, (1929) 16 B. T. A. 425.

²⁰⁰*New Creek Co. v. Lederer*, (C.C.A. 3d Cir. 1924) 295 Fed. 433 (royalty value prorated); *Westerfield v. Rafferty* (E.D. N.Y. 1925) 4 F. (2d) 590 (carrying charges deducted in year paid and not capitalized); *Kentucky Tobacco Products Co. v. Lucas*, (W.D. Ky. 1925) 5 F. (2d) 723 (value of contract prorated); *American Can Co. v. Bowers*, (C.C.A. 2d Cir. 1929) 35 F. (2d) 832 (losses on inventories deducted in year suffered).

²⁰¹(1916) 240 U. S. 103, 36 Sup. Ct. 278, 60 L. Ed. 546.

²⁰²*Magill, Taxable Income* (1936) 310.

²⁰³(S.D. N.Y. 1930) 46 F. (2d) 164, *aff'd* (C.C.A. 2d Cir. 1931) 49 F. (2d) 996, cert. denied, (1931) 284 U. S. 641, 52 Sup. Ct. 22, 76 L. Ed. 545.

²⁰⁴(S.D. N.Y. 1930) 46 F. (2d) 164, 167. This statement was followed by a quotation from *New York, N. H. & H. R. v. United States*, (C.C.A. 2d Cir. 1920) 269 Fed. 907, 910, a case which discussed the provision in the Corporation Excise Tax Act of 1909 limiting the interest expense of corporations. In *Spring Canyon Coal Co. v. Commissioner*, (C.C.A. 10th Cir. 1930) 43 F. (2d) 78, 79, cert. denied, (1931) 284 U. S. 654, 52 Sup. Ct.

However, the Supreme Court at first refused to accept these broad statements concerning the statutory nature of deductions. In *Burnet v. Thompson Oil & Gas Co.*,²⁰⁵ a case involving the depletion basis for an oil well, the court said:

"The parties agree that respondent is not entitled as a matter of right to make any deduction from annual income for depletion of the oil extracted and sold during the year. If it may take any such deduction, authority therefore must be found in the statute. (*Stanton v. Baltic Mining Co.*)"²⁰⁶

It should be observed that the Court did not say that all deductions were purely statutory, it merely said that any deduction for depletion must be authorized by statute. Yet of the eleven cases citing the *Thompson Case* as authority for the principle that deductions are statutory, only two of them limit their remarks to deductions for depletion.²⁰⁷ The remainder cite it for the rule that all deductions are matters of congressional discretion.²⁰⁸

33, 76 L. Ed. 554, decided in the same year, the federal court did not qualify its remarks even on the question of discrimination. In rejecting the proposal of the taxpayer to deduct estimated expenses incurred under a state workman's compensation statute instead of the actual payments made to injured employees, the Court said that "Deductions from income may not be made unless authorized by statute."

²⁰⁵(1931) 283 U. S. 301, 51 Sup. Ct. 418, 75 L. Ed. 1049.

²⁰⁶(1931) 283 U. S. 301, 304, 51 Sup. Ct. 418, 419, 75 L. Ed. 1049. Cf. *Pugh v. Commissioner*, (C.C.A. 5th Cir. 1931) 49 F. (2d) 76, 77, cert. denied, (1931) 284 U. S. 642, 52 Sup. Ct. 22, where it was said that "a deduction from gross income can be claimed only as authorized by statute." See also, *Planters' Cotton Oil Co. v. Hopkins*, (C.C.A. 5th Cir. 1931) 53 F. (2d) 825, 826, aff'd (1932) 286 U. S. 332, 52 Sup. Ct. 509, 76 L. Ed. 1135, a case involving an attempt to carry over the losses of a predecessor corporation. In denying the deduction the Court said that "The rights of claimants must rest upon the express terms of the statute, they have no natural spring." In *Kenan v. Bowers*, (C.C.A. 2d Cir. 1931) 50 F. (2d) 112, 113, where additional compensation paid trustees by the beneficiary of a trust was excluded as a deduction from the beneficiary's gross income since there was no statutory provision therefor and that it was "only by way of legislative favor that any taxpayer has the benefit of any deductions." In *Robinson Davis Lumber Co. v. Crooks*, (W.D. Mo. 1931) 50 F. (2d) 638, a deduction for a bad debt was disallowed because the taxpayer failed to comply with the statute. "There must be strict compliance with . . . statute if relief is to be had under it." In *Otto Keusch*, (1931) 23 B. T. A. 216, 219, 220, the board said that "All the revenue acts have authorized certain deductions in computing taxable net income, but have eliminated the deductions which may be taken by individuals with respect to losses sustained by them. Taxable net income is, therefore, a statutory concept and under none of the acts is it in excess of the income upon which the Sixteenth Amendment authorizes Congress to impose and collect a tax."

²⁰⁷*Darby-Lynde Co. v. Commissioner*, (C.C.A. 10th Cir. 1931) 51 F. (2d) 32 (discovery value denied transferee); *Phoenix Oil Production Co. v. Commissioner*, (1932) 25 B. T. A. 1239 (discovery value eliminated from statute).

²⁰⁸*Helvering v. Independent Life Insurance Co.*, (1934) 292 U. S. 371, 54 Sup. Ct. 758, 78 L. Ed. 1311 (conditional deduction for depreciation);

This tendency on the part of the lower federal courts to expand the language of the Supreme Court to include all deductions is further illustrated by *Woolford Realty Co. v. Rose*.²⁰⁹ In that case the commissioner had refused to permit the deduction of a loss of a subsidiary company, suffered before affiliation, from the consolidated return of the operating unit. The Court, in sustaining the action of the commissioner, said:

"A taxpayer who seeks an allowance for losses suffered in an earlier year, must be able to point to a specific provision of the statute permitting the deduction, and must bring himself within its terms. Unless he can do this, the operations of the current year must be the measure of his burden."²¹⁰

Winmill v. Commissioner, (C.C.A. 2d Cir. 1937) 93 F. (2d) 494 (taxpayer denied right to deduct security losses from joint security profits); *Baltimore & Ohio R. Co. v. Commissioner*, (C.C.A. 4th Cir. 1935) 78 F. (2d) 456 (disallowance of bond expense previously deducted); *Baltimore & Ohio R. Co. v. Commissioner*, (C.C.A. 4th Cir. 1935) 78 F. (2d) 460 (nominal discount on stock disallowed); *Brandon Corporation v. Commissioner* (C.C.A. 4th Cir. 1934) 71 F. (2d) 762 (new corporation denied right to deduct loss of predecessor suffered during same year); *New World Life Ins. Co. v. United States*, (1939) 89 Ct. Cl. 558, 26 F. Supp. 444 (allocation of general expense); *Jefferson & Clearfield Coal & Iron Co. v. United States*, (1936) 83 Ct. Cl. 712, 14 F. Supp. 918 (allowed depletion less than actual depletion); *Thomason v. Commissioner*, (1935) 33 B. T. A. 576 (deduction of accrued interest denied taxpayer on cash basis); *Glide v. Commissioner*, (1933) 27 B. T. A. 1264 (bonus payment not subject to statutory depletion when wells not brought into operation).

²⁰⁹(1932) 286 U. S. 319, 52 Sup. Ct. 568, 76 L. Ed. 1128.

²¹⁰(1932) 286 U. S. 319, 326, 52 Sup. Ct. 568, 569, 76 L. Ed. 1128.

Other federal cases decided during 1932 showed something of the same reluctance illustrated in the *Woolford* decision to make sweeping generalizations. *Martin v. Commissioner*, (C.C.A. 2d Cir. 1932) 61 F. (2d) 942, 944; *Palmer v. Bender*, (C.C.A. 5th Cir. 1932) 57 F. (2d) 32, 33-34; *Phoenix Oil Production Co. v. Commissioner*, (1932) 25 B. T. A. 1239, 1241. However, this was by no means true of the majority of the decisions handed down during that year. In *Prairie Oil & Gas Co. v. Motter*, (D. Kan. 1932) 1 F. Supp. 464, 467, a district court suggested that "Owners of oil, gas, and mining properties are not entitled as a matter of right to deduct anything from the receipts of the operations of such properties. The entire receipts from the operations of mines and oil and gas wells are incomes and are taxable in their entirety." The court of claims during the same year remarked that "it is for Congress to say, within reasonable limits at least, how the tax shall be measured and what deductions should be made in computing the tax on the income, or, in its wisdom and discretion, it may refuse to allow any." The court then continued: "We do not think that the constitutional amendment required Congress to impose a tax on net income in a technical sense, for, if it did, the income tax would be almost impossible to administer in many if not in most cases." *Hecht v. United States*, (1932) 77 Ct. Cl. 225, 54 F. (2d) 968, 973, cert. denied, (1932) 286 U. S. 560, 52 Sup. Ct. 648, 76 L. Ed. 1293. And in *Lloyd v. Commissioner*, (C.C.A. 7th Cir. 1932) 55 F. (2d) 842, 844, a taxpayer was denied the right to deduct the expense incurred in the prosecution of a successful action for slander since he was said to have "no right to any deductions from his gross income unless such deductions are provided for by the Revenue Statute." See also, *White v. Commissioner*, (C.C.A. 9th Cir. 1932) 61 F. (2d) 726, 728; *Lloyd v. Commissioner*, (C.C.A. 7th Cir.

Although the above statement obviously referred only to the deduction of past losses,²¹¹ it was later cited in seven cases²¹² in connection with the power of Congress over deductions and only one of them²¹³ limited the language of the Court to the deduction actually under consideration in the *Woolford Case*. The remaining six cases cited it for the broad rule that the *only* deductions allowable are those specifically authorized by statute.

As late as 1934 the Supreme Court followed its earlier practice, and carefully limited its remarks concerning the power of Congress over deductions to the specific cases before it for decision.²¹⁴ However, during that year the Court for the first time accepted the unconditional statements which had been made with increasing frequency by the lower federal courts. In *Helvering v. Independent Life Insurance Co.*,²¹⁵ the Court had under consideration the provision in the Act of 1921 which denied life insurance companies the right to deduct depreciation on the premises occupied by it unless the rental value, measured by four per cent of the book value of the building occupied, was included in the company's gross income. In sustaining the conditional deduction the Court found occasion to remark

1932) 55 F. (2d) 842; *Prairie Oil & Gas Co. v. Motter*, (C.C.A. 10th Cir. 1933) 66 F. (2d) 309; *Houston Production Co. v. United States*, (S.D. Tex. 1933) 4 F. Supp. 715; *Glide v. Commissioner*, (1933) 27 B. T. A. 1264; *Comar Oil Co. v. Burnet*, (C.C.A. 8th Cir. 1933) 64 F. (2d) 965. Cf. *Lindley v. Commissioner*, (C.C.A. 2d Cir. 1933) 63 F. (2d) 807; *Squier v. Commissioner*, (C.C.A. 2d Cir. 1933) 68 F. (2d) 25; *New Colonial Ice Co. v. Commissioner*, (C.C.A. 2d Cir. 1933), 66 F. (2d) 480.

²¹¹In *Jankowsky v. Commissioner*, (C.C.A. 10th Cir. 1932) 56 F. (2d) 1006, 1008, it was said of past losses that "It is a mere truism to say that petitioner in making up his income tax return . . . was entitled to enter such deductions only as were at that time authorized by law."

²¹²*Merchants' Bank Bldg. Co. v. Helvering*, (C.C.A. 8th Cir. 1936) 84 F. (2d) 478; *Baltimore & Ohio R. Co. v. Commissioner*, (C.C.A. 4th Cir. 1935) 78 F. (2d) 460; *Empire Trust Company v. Commissioner*, (C.C.A. 4th Cir. 1938) 94 F. (2d) 307, 310; *Brandon Corporation v. Commissioner*, (C.C.A. 4th Cir. 1934) 71 F. (2d) 762; *Barbour Coal Co. v. Commissioner*, (C.C.A. 10th Cir. 1934) 74 F. (2d) 163; *Martin v. Commissioner*, (C.C.A. 2d Cir. 1932) 61 F. (2d) 942, cert. denied, (1933) 289 U. S. 737, 53 Sup. Ct. 656; *S. E. Thomason*, (1935) 33 B. T. A. 576.

²¹³*Martin v. Commissioner*, (C.C.A. 2d Cir. 1932) 61 F. (2d) 942, cert. denied, (1933) 289 U. S. 737, 53 Sup. Ct. 656 (taxpayer denied right to prorate loss on installment sale).

²¹⁴In *Charles Ilfeld Co. v. Hernandez*, (1932) 292 U. S. 62, 66, 54 Sup. Ct. 596, 598, 78 L. Ed. 1127, the Court limited its language to the case at hand. The corporate taxpayer claimed a deduction for loss sustained in the sale of its subsidiary's assets. In sustaining the rejection of the taxpayer's claim, the Court said that the *deduction claimed* was not allowable "in the absence of a provision in the Act or regulations that fairly may be read to authorize it."

²¹⁵(1934) 292 U. S. 371, 54 Sup. Ct. 758, 78 L. Ed. 1311.

"Unquestionably Congress has power to condition, limit, or deny deductions from gross income in order to arrive at the net that it chooses to tax."²¹⁶

In support of this sweeping statement the Court cited three cases: *Burnet v. Thompson Oil & Gas Co.*,²¹⁷ *Stanton v. Baltic Mining Co.*²¹⁸ and *Brushaber v. Union Pacific R. Co.*²¹⁹ The first, as has been noted, referred only to deductions for depletion. The second also related to depletion but, like the third, which considered a broadside objection to the Act of 1913, based its decision largely on the excise character of the income tax.

Although the *Independent Life Insurance Co. Case* as well as the cases cited related to the taxation of corporations, the language used by the Court was not so limited. Therefore it was not to be expected that the remarks contained in the cases following the decision would be restricted either to the situations falling within the scope of the Act of 1909 or to the particular deductions before the court for decision.²²⁰

One week after the *Independent Life Insurance Co. Case* the Supreme Court decided its most frequently cited decision on the subject of the power of Congress over deductions. In *New Colonial Ice Co. v. Helvering*,²²¹ the Court said:

"The power to tax income like that of the new corporation is plain and extends to the gross income. Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed."²²²

Since the case involved the right to deduct the past losses of another corporation, it presented no constitutional problem—and this had been recognized by the court below.²²³ Yet more than forty cases have been found which cite the *New Colonial* decision

²¹⁶(1934) 292 U. S. 371, 381, 54 Sup. Ct. 758, 760, 78 L. Ed. 1311.

²¹⁷(1931) 283 U. S. 301, 51 Sup. Ct. 418, 75 L. Ed. 1049.

²¹⁸(1916) 240 U. S. 103, 36 Sup. Ct. 278, 60 L. Ed. 546.

²¹⁹(1916) 240 U. S. 1, 36 Sup. Ct. 236, 60 L. Ed. 493.

²²⁰*Helvering v. Winmill*, (1938) 305 U. S. 79, 59 Sup. Ct. 45, 83 L. Ed. 52; *Winmill v. Commissioner*, (C.C.A. 2d Cir. 1937) 93 F. (2d) 494, 495; *Weber Flour Mills Co. v. Commissioner*, (C.C.A. 10th Cir. 1936) 82 F. (2d) 764; *McGinley Corporation v. Commissioner*, (C.C.A. 5th Cir. 1936) 82 F. (2d) 56, 57; *Merchants' Bank Bldg. Co. v. Helvering*, (C.C.A. 8th Cir. 1936) 84 F. (2d) 478, 481; *Avery v. Commissioner*, (C.C.A. 7th Cir. 1936) 84 F. (2d) 905, 907; *Commodore Mining Co. v. Commissioner*, (C.C.A. 10th Cir. 1940) 111 F. (2d) 131, 133; *J. E. Riley Inv. Co. v. Commissioner*, (C.C.A. 9th Cir. 1940) 110 F. (2d) 655, 658.

²²¹(1934) 292 U. S. 435, 54 Sup. Ct. 788, 78 L. Ed. 1348.

²²²(1934) 292 U. S. 435, 440, 54 Sup. Ct. 788, 790, 78 L. Ed. 1348.

²²³(C.C.A. 2d Cir. 1933) 66 F. (2d) 480.

as authority for the principle that every deduction is purely statutory or is a matter of legislative grace.²²⁴

Until 1934 all of the Supreme Court and a majority of the lower court decisions carefully limited their statements concerning deductions to the facts of the case presented for decision. Perhaps it was recognized that the various deductions contained in one section lacked homogeneity. To say that Congress could deny the deduction of a charitable contribution was quite a different thing from saying that Congress could deny the deduction of expenses necessarily incurred in securing gross income or that current business losses could not be deducted from operating profits. The deductions enumerated in the act presented somewhat distinct constitutional problems.²²⁵ For example, the deduc-

²²⁴*Safe Deposit & Trust Co. v. Magruder*, (D. Md. 1940) 34 F. Supp. 199, 203; *Empire Trust Co. v. Commissioner*, (C. C. A. 4th Cir. 1938) 94 F. (2d) 307, 310; *Commodore Mining Co. v. Commissioner*, (C.C.A. 10th Cir. 1940) 111 F. (2d) 131, 133; *Cooperative Oil Ass'n v. Commissioner*, (C.C.A. 9th Cir. 1941) 115 F. (2d) 666, 668, 669; *Deputy v. Du Pont*, (1940) 308 U. S. 488, 60 Sup. Ct. 363, 84 L. Ed. 431; *White v. United States*, (1938) 305 U. S. 281, 59 Sup. Ct. 179, 83 L. Ed. 172; *Helvering v. Inter-Mountain Life Insurance Co.*, (1935) 294 U. S. 686, 55 Sup. Ct. 572, 79 L. Ed. 1227; *United States v. Donaldson Realty Co.*, (C.C.A. 8th Cir. 1939) 106 F. (2d) 509; *Scripps v. Commissioner*, (C.C.A. 6th Cir. 1938) 96 F. (2d) 492; cert. denied, (1938) 305 U. S. 625, 59 Sup. Ct. 86, 83 L. Ed. 400; *Bagnall v. Commissioner*, (C.C.A. 9th Cir. 1938) 96 F. (2d) 956; *Helvering v. Obici*, (C.C.A. 4th Cir. 1938) 97 F. (2d) 431, aff'd (1939) 305 U. S. 468, 59 Sup. Ct. 260, 83 L. Ed. 292; *Walsh-McGuire Co. v. Commissioner*, (C.C.A. 6th Cir. 1938) 97 F. (2d) 983; *Commissioner v. Trustees of Lumber Inv. Ass'n*, (C.C.A. 7th Cir. 1938) 100 F. (2d) 18; *Walker v. Commissioner*, (C.C.A. 5th Cir. 1937) 91 F. (2d) 297; *Sabath v. Commissioner*, (C.C.A. 7th Cir. 1938) 100 F. (2d) 569; *Avery v. Commissioner*, (C.C.A. 7th Cir. 1936) 84 F. (2d) 905; *Merchants' Bank Bldg. v. Helvering*, (C.C.A. 8th Cir. 1936) 84 F. (2d) 478; *McGinley Corporation v. Commissioner*, (C.C.A. 5th Cir. (1936) 82 F. (2d) 56; *Weber Flour Mills Co. v. Commissioner*, (C.C.A. 10th Cir. 1936) 82 F. (2d) 764; *Motion Picture Capital Corp. v. Commissioner*, (C.C.A. 2nd Cir. 1936) 80 F. (2d) 872; *Shapleigh Hardware Co. v. United States*, (C.C.A. 8th Cir. 1936) 81 F. (2d) 697; *Remco S. S. Co. v. Commissioner*, (C.C.A. 9th Cir. 1936) 82 F. (2d) 988, cert. den. (1936) 299 U. S. 555, 57 Sup. Ct. 17; *Pennsylvania Company for Insurances, v. Commissioner*, (C.C.A. 3d Cir. 1935) 75 F. (2d) 719; *Surety Finance Co. v. Commissioner*, (C.C.A. 9th Cir. 1935) 77 F. (2d) 221; *Langford Investment Co. v. Commissioner*, (C.C.A. 5th Cir. 1935) 77 F. (2d) 468; *Baltimore & Ohio R. Co. v. Commissioner*, (C.C.A. 4th Cir. 1935) 78 F. (2d) 456; *Baltimore & Ohio R. Co. v. Commissioner*, (C.C.A. 4th Cir. 1935) 78 F. (2d) 460; *O'Laughlin v. Helvering*, (1935) 65 App. D. C. 135, 81 F. (2d) 269; *Barbour Coal Co. v. Commissioner*, (C.C.A. 10th Cir. 1934) 74 F. (2d) 163, cert. den. (1935) 295 U. S. 731, 55 Sup. Ct. 643; *Edward J. White*, (1938) 37 B. T. A. 1106; *Robert P. Scripps*, (1936) 33 B. T. A. 962; *Frederick H. Wood*, (1936) 34 B. T. A. 1252; *Helen H. Heilbronner*, (1936) 34 B. T. A. 1200; *Word Specialty Manufacturing Co.*, (1936) 34 B. T. A. 974; *American Arch Co.*, (1935) 33 B. T. A. 705; *S. E. Thomason*, (1935) 33 B. T. A. 576; *Paul Pryibil*, (1934) 31 B. T. A. 164.

²²⁵See *Davis v. United States*, (C.C.A. 2d Cir. 1937) 87 F. (2d) 323.

tion of losses presented the problem of the power of Congress to tax profitable years and transactions and to ignore unprofitable ones; the deduction of expense raised the question of whether Congress could tax the return of capital; while the deduction for charitable contributions related to the problem of classification—the extent to which Congress may grant exemptions from taxation and the power to classify gifts, permitting the deduction of some and denying the deduction of others.

However, with the *Independent Life Insurance Co.* and *New Colonial Ice Co.* opinions, there was a decided shift in judicial sentiment. The cases decided thereafter were, with only a few exceptions, unlimited in their scope.²²⁶ The power of Congress over deductions was absolute.²²⁷

²²⁶Of the eighty cases following *Helvering v. Independent Life Ins. Co.*, (1934) 292 U. S. 371, 54 Sup. Ct. 758, 78 L. Ed. 1311, and *New Colonial Ice Co. v. Helvering*, (1934) 292 U. S. 435, 54 Sup. Ct. 788, 78 L. Ed. 1311, sixty-nine speak of the power of Congress over deductions as being unlimited. See cases cited supra, note 224. See also *First National Bank & Trust Co. v. United States*, (C.C.A. 5th Cir. 1941) 115 F. (2d) 194, 195 (limited deduction for loss); *Chicago & N. W. R. Co. v. Commissioner*, (C.C.A. 7th Cir. 1940) 114 F. (2d) 882, 887 (charitable contribution); *Consolidated Dry Goods Co. v. United States*, (D. Mass. 1940) 35 F. Supp. 523, 525; *J. E. Riley Inv. Co. v. Commissioner*, (C.C.A. 9th Cir. 1940) 110 F. (2d) 655, 658 (depletion controversy); *Manufacturers Trust Co. v. United States*, (1940) 92 Ct. Cl. 622, 32 F. Supp. 289, 296 (losses not off-set against gains under Silver Purchase Act of 1934); *Markwell's Estate v. Commissioner*, (C.C.A. 7th Cir. 1940) 112 F. (2d) 253, 255 (estate tax decision); *United States v. Sentinel Oil Co.*, (C.C.A. 9th Cir. 1940) 109 F. (2d) 854; *Jones v. Commissioner*, (C.C.A. 9th Cir. 1939) 103 F. (2d) 681; *United States v. O. J. Morrison Stores*, (C.C.A. 4th Cir. 1938) 99 F. (2d) 77; *Dexter v. Commissioner*, (C.C.A. 1st Cir. 1938) 99 F. (2d) 769; *Winmill v. Commissioner*, (C.C.A. 2d Cir. 1937) 93 F. (2d) 494; *Crowley v. Commissioner*, (C.C.A. 6th Cir. 1937) 89 F. (2d) 715; *Cleveland Shopping News Co. v. Routzahn*, (C.C.A. 6th Cir. 1937) 89 F. (2d) 902; *Bermont Oil Co. v. Helvering*, (1937) 67 App. D. C. 256, 91 F. (2d) 710; *Johnston v. Commissioner*, (C.C.A. 2nd Cir. 1936) 86 F. (2d) 732, cert. den. (1937) 301 U. S. 683, 57 Sup. Ct. 784; *Old Colony Trust Co. v. Commissioner*, (C.C.A. 1st Cir. 1936) 87 F. (2d) 131; *Brandon Corporation v. Commissioner*, (C.C.A. 4th Cir. 1934) 71 F. (2d) 762; *Craik v. United States*, (1940) 90 Ct. Cl. 345, 31 F. Supp. 132; *New World Life Ins. Co. v. United States*, (1939) 89 Ct. Cl. 558, 26 F. Supp. 444; *Pleasants v. United States*, (1938) 86 Ct. Cl. 754, 22 F. Supp. 964; *Chisolm v. United States*, (1937) 85 Ct. Cl. 701, 19 F. Supp. 274; *Jefferson & Clearfield Coal & Iron Co. v. United States*, (1936) 83 Ct. Cl. 712, 14 F. Supp. 918; *Faber v. United States*, (1935) 81 Ct. Cl. 980, 10 F. Supp. 602; *Du Pont v. Commissioner*, (1938) 37 B. T. A. 1198; *William F. Humphrey*, (1935) 33 B. T. A. 442. Only eleven purported to state a rule limited to the deduction under consideration. *Anderson v. Helvering* (1940) 310 U. S. 404, 60 Sup. Ct. 952, 84 L. Ed. 1277 (deduction for depletion and depreciation said to be an act of grace); *Helvering v. Mountain Producers Corporation*, (1938) 303 U. S. 376, 58 Sup. Ct. 623, 82 L. Ed. 907 (depletion deduction an act of grace); *Helvering v. Bankline Oil Co.*, (1938) 303 U. S. 362, 58 Sup. Ct. 616, 82 L. Ed. 897 (deduction for depletion an act of grace); *Miller v. Commissioner*, (C.C.A.

IX.

But the statement that the power of Congress over deductions is absolute does not necessarily lead to the conclusion that the Supreme Court will sanction a tax on gross receipts. The present act impliedly excludes total receipts from the taxpayer's return.²²⁸ Only those receipts containing some element of profit need be reported and then only after deducting the "cost of goods sold."²²⁹ Congress has been exceedingly generous in providing for exemptions, credits and deductions, so that authority on the question of the power of Congress to tax gross receipts is difficult to find. There appears to be no immediate prospect that a gross receipts tax in the guise of an income tax will be levied. However, if the attempt should be made the Supreme Court will be compelled to choose between the explicit concept of taxable income in *Eisner v. Macomber*²³⁰ and the implicit concept found in *Stanton v. Baltic Mining Co.*²³¹—and Supreme Court decisions are to be found which indicate that the latter concept may be accepted when the question is squarely presented to the Court.

In *Deputy v. Dupont*,²³² the taxpayer borrowed stock from a corporation under an agreement whereby he was required to

9th Cir. 1940) 115 F. (2d) 479, 480 (net loss carryover); *Lucky Tiger-Combination Gold Mining Co. v. Crooks*, (C.C.A. 8th Cir. 1938) 95 F. (2d) 885 (depletion deduction a matter of grace); *Davis v. United States*, (C.C.A. 2nd Cir. 1937) 87 F. (2d) 323 (two types of deductions, only one a matter of congressional grace); *Van Vleck v. Commissioner*, (C. C. A. 2d Cir 1935) 80 F. (2d) 217 (deduction of past losses depends upon legislative grace); *Commissioner v. Riggs*, (C.C.A. 3d Cir. 1935) 78 F. (2d) 1004; *Champlin v. Commissioner*, (C.C.A. 10th Cir. 1935) 78 F. (2d) 905 (allowance for depletion a matter of grace); *Courier Journal Job Printing Co. v. Glenn*, (W.D. Ky. 1941) 37 F. Supp. 55, 58 (loss properly deducted); *Hurley v. United States* (N.D. Okla., 1935) 10 F. Supp. 365 (allowance for depletion a matter of grace).

²²⁷"Every deduction from gross income is allowed as a matter of legislative grace." *White v. United States*, (1938) 305 U. S. 281, 292, 59 Sup. Ct. 179, 184, 83 L. Ed. 172. *Deputy v. Du Pont*, (1940) 308 U. S. 488, 60 Sup. Ct. 363, 84 L. Ed. 416, and *Helvering v. Winmill*, (1938) 305 U. S. 79, 84, 59 Sup. Ct. 45, 47, 83 L. Ed. 52. Cf. *Davis v. United States*, (C.C.A. 2d Cir. 1937) 87 F. (2d) 323, 324-325; *Holmes*, *Federal Taxes* (6th ed. 1925) 506.

²²⁸"'Gross income' includes gains, profits, and income derived from salaries, wages or compensation for personal service . . . or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, . . . also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. . . ." Revenue Act of 1939, sec. 22(a).

²²⁹Prentice-Hall 1940 Federal Tax Service Par. 17,004.

²³⁰(1920) 252 U. S. 189, 40 Sup. Ct. 189, 64 L. Ed. 521.

²³¹(1916) 240 U. S. 103, 36 Sup. Ct. 278, 60 L. Ed. 546.

²³²(1940) 308 U. S. 488, 60 Sup. Ct. 363, 84 L. Ed. 416.

return the stock in kind at the end of a stated number of years and "in the interim to pay to the lender all dividends declared and paid on the shares so loaned." Although the Supreme Court agreed that "he was little more than a conduit," the statute did not provide for a deduction of this character and the dividends received (and included in gross income) could not be deducted even though paid to the lender in accordance with the requirements of an admittedly valid agreement.

"Allowance of deductions from gross income does not turn on general equitable considerations. It 'depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed.' *New Colonial Ice Co., Inc. v. Helvering*."²³³

Since the taxpayer paid over the dividends in the year actually received and was required to report these dividends in his taxable income,²³⁴ a clearer case of taxing gross receipts cannot be imagined.²³⁵ Although the government suggested that the payments were capital in nature,²³⁶ Mr. Justice Roberts in his dissent remarked that the carrying charge was either a business expense "or it was nothing of consequence under any provision of the statute."²³⁷

An earlier case, *Burnet v. Sanford & Brooks Co.*,²³⁸ furnishes an additional illustration of the use of the income tax to tax gross receipts. From 1913 to 1916 the taxpayer was engaged in dredging the Delaware River for the federal government. Because of a breach of warranty of the character of the materials to be dredged, actual expenses exceeded the payments received from the United States by \$176,271.88. Suit was brought and judgment recovered

²³³(1940) 308 U. S. 488, 493, 60 Sup. Ct. 363, 366, 84 L. Ed. 416.

²³⁴See *Pierre S. Du Pont*, (1938) 37 B. T. A. 1198, 1272, 1278 which involved a different tax year, but the Board said that the facts were identical with *Du Pont v. Deputy*, (1940) 22 F. Supp. 589, aff'd 308 U. S. 488, 60 Sup. Ct. 363, 84 L. Ed. 416.

²³⁵In *Brown v. Helvering*, (1934) 291 U. S. 193, 54 Sup. Ct. 356, 78 L. Ed. 725, a general agent for an insurance company was required to pay an income tax on the full amount of commissions received during the year even though it was recognized that a part of the commissions would have to be returned to the insurance company because of the cancellation of policies. See also, *North American Oil Consolidated v. Burnet*, (1932) 286 U. S. 417, 424, 52 Sup. Ct. 613, 615, 76 L. Ed. 1197, where it was said: "If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent."

²³⁶(1940) 308 U. S. 488, 499, 60 Sup. Ct. 363, 369, 84 L. Ed. 416.

²³⁷(1940) 308 U. S. 488, 502, 60 Sup. Ct. 363, 370, 84 L. Ed. 416.

²³⁸(1931) 282 U. S. 359, 51 Sup. Ct. 150, 75 L. Ed. 383.

in 1920. When the taxpayer failed to include the judgment in his gross income for the year the commissioner made a deficiency assessment for this amount. Although the judgment clearly represented a mere return of the expenditures, the Supreme Court brushed aside the objection that the tax was not laid on income (and therefore void because not apportioned) by the simple expedient of calling the receipts income.²³⁹ The Court knew that the receipts were income because Congress had clearly expressed an intention to include such payments in the taxpayer's return.²⁴⁰ That the Court should rely upon the intention of Congress is not surprising, since it is doubtful that the most optimistic and inaccurate layman would consider the reimbursement of past expenses "profits."

In *Spring City Foundry Co. v. Commissioner*,²⁴¹ the taxpayer sold goods on credit and the debtor shortly thereafter became bankrupt. Although there could be no doubt that a large part of the debt would be lost, the taxpayer was required to include the full amount in its gross income. Since the company was permitted to deduct the expenses connected with the sale from gross income, there was no question as to the taxation of gross receipts. But unless the net profit from the transaction amounted to more than 72½ per cent of the selling price, there was no profit to be taxed.²⁴² The difference between the amount of profit and the 72½ per cent clearly represented a loss to the company. But even if the net profit amounted to more than 72½ per cent of the selling price the taxpayer was not taxed on this basis; it was taxed on the lost profits as well,—an amount much larger than any possible actual net return. To justify the decision on the ground that the loss could be deducted from gross income during the year in which its amount was finally ascertained requires the acceptance of the theory that Congress may tax during the current year hypothetical profits which may or may not be realized in the year in which the loss is determined. And to point out that a different result could have been obtained by reporting income on a cash

²³⁹"If respondent's contention that only gain or profit may be taxed under the sixteenth amendment be accepted without qualification, the question remains whether the gain or profit which is the subject of the tax may be ascertained, as here, on the basis of fixed accounting periods. . . ." 282 U. S. 359, 362, 363, 51 Sup. Ct. 150, 151, 75 L. Ed. 383.

²⁴⁰282 U. S. 359, 363, 51 Sup. Ct. 150, 151, 75 L. Ed., 383.

²⁴¹(1934) 292 U. S. 182, 54 Sup. Ct. 644, 78 L. Ed. 1200.

²⁴²The taxpayer later received dividends totalling 27½%. 292 U. S. 182, 183, 54 Sup. Ct. 644, 78 L. Ed. 1200.

receipts basis fails to meet the constitutional issue in question. Unless it is assumed that Congress could not require the use of an accrual basis, and unless it is further assumed that the Supreme Court did not actually mean that deductions are a matter of congressional grace, it must follow that Congress has the power to tax as income a profitless transaction.

An even clearer example of a transactions "income" tax is found in *Helvering v. Midland Mutual Life Insurance Co.*²⁴³ In that case the taxpayer foreclosed mortgages on real estate given to secure loans which were in default. The company was the only bidder and in each case the amount of the bid included both the principal and accrued interest. Since the property received in return for the defaulted loan was less than the capital originally expended by the company, it was argued that under the rule of *Doyle v. Mitchell Bros. Co.*²⁴⁴ there could be no taxable income from the foreclosure. This contention was rejected by Mr. Justice Brandeis on the ground that Congress intended to include as income the "interest" credited to the taxpayer as part of the purchase price of the property bid in at the foreclosure sale. The transaction was treated as if the property had been pur-

²⁴³(1937) 300 U. S. 216, 57 Sup. Ct. 423, 81 L. Ed. 612.

²⁴⁴(1918) 247 U. S. 179, 38 Sup. Ct. 467, 62 L. Ed. 1054; *supra*, pp. 425-6. It seems strange that a case decided solely on a basis of *statutory construction* should be so frequently cited for the proposition that Congress has no *constitutional* power to tax the conversion of assets. That the Court was merely interpreting the intention of Congress appears at frequent intervals in the decision. For example, it was said that "legislative purpose was not to tax property as such, or the mere conversion of property." 247 U. S. 179, 183, 38 Sup. Ct. 467, 62 L. Ed. 1054, and "By the true intent and meaning of the act the entire proceeds of a mere conversion of capital assets were not to be treated as income." 247 U. S. 184. The Treasury Regulations provided that "the cutting from timber lands . . . [were to be] considered simply a change in the form of assets" and the Court agreed with the taxpayer that this was a proper interpretation of the statute. An earlier case, *Stratton's Independence, Ltd. v. Howbert*, (1913) 231 U. S. 399, 34 Sup. Ct. 136, 58 L. Ed. 285, had rejected the contention that Congress had no *power* to tax the conversion of assets. Although the Doyle Case permitted the deduction of the value of the stumpage cut during the year while the Howbert Case denied the deduction of depletion, the accuracy with which standing timber could be valued as compared with the difficulty of valuing sub-surface minerals may have justified the conclusion that Congress intended "to permit the deduction of capital in the case where it was readily ascertained and did not intend to deduct the return of capital in the case where the value was highly conjectural." Congress evidently intended to adopt a measure of the tax that should be easy of ascertainment and simply and readily applied in practice, (1913) 231 U. S. 399, 417, 34 Sup. Ct. 136, 58 L. Ed. 285. *Von Baumbach v. Sargent Land Co.*, (1917) 242 U. S. 503, 37 Sup. Ct. 201, 61 L. Ed. 460; *United States v. Biwabik Mining Co.*, (1918) 247 U. S. 116, 38 Sup. Ct. 462, 62 L. Ed. 1017; *Goldfield Consolidated Mines Co. v. Scott*, (1918) 247 U. S. 126, 38 Sup. Ct. 465, 62 L. Ed. 1022.

chased by a stranger and the proceeds turned over to the company in full payment of principal and interest.²⁴⁵ The constitutional approach was rejected and the controversy limited to a matter of statutory interpretation. From a reading of this decision it would appear that the question was no longer one of whether Congress had the power to tax as income that which was not income, but was whether Congress intended to tax as income that which was not income.

"Where the legal effect of a transaction fits the plain letter of the statute, the tax is held payable, unless there is clearly revealed in the act itself or in its history a definite intention to exclude such transaction from the operation of its applicable language."²⁴⁶

In the four cases just mentioned it is apparent that the Court permitted the taxation of something other than income by an "income tax." In the *Dupont Case* the tax was laid upon a profitless receipt and delivery of dividends; in *Sanford & Brooks Co.* the tax was laid upon the restoration of capital; in *Spring City Foundry Co.* the taxpayer was compelled to pay a tax on a profitless sale; while in *Midland Mutual Life Insurance Co.* the company was required to pay a tax on interest which it had never received.²⁴⁷ Although these cases violate all conventions of accounting and in no way conform to the orthodox concepts of income, it is clear that Congress was merely taxing events which could have been reached by an excise tax; and if the income tax may be considered as being one form of an excise²⁴⁸ there can be no constitutional objections to these decisions.²⁴⁹

²⁴⁵The "same as if" argument made in connection with stock dividends was rejected by the Court in *Eisner v. Macomber*, (1920) 252 U. S. 189, 40 Sup. Ct. 189, 64 L. Ed. 521. "It is said there is no difference between a simple stock dividend and a case where stockholders use money received as cash dividends to purchase additional stock contemporaneously issued by the corporation. But an actual cash dividend, with a real option to the stockholder either to keep the money for his own or to reinvest it in new shares, would be as far removed as possible from a true stock dividend, such as the one we have under consideration, where nothing of value is taken from the company's assets and transferred to the individual ownership of the several stockholders and thereby subject to their disposal." 252 U. S. 189, 215. See dissenting opinion of Brandeis, J., 252 U. S. 189, 227, 228.

²⁴⁶(1937) 300 U. S. 216, 224, 57 Sup. Ct. 423, 426, 81 L. Ed. 612.

²⁴⁷In this connection see *Dohr, Income Divorced From Reality*, (1938) 66 *Journal of Accountancy* 361.

²⁴⁸For statements to the effect that an income tax is an excise, or indirect tax, see *Magill, Taxable Income* (1936) 329; *Rottschaefer, Constitutional Law* (1939) 190.

²⁴⁹That Congress may tax the gross receipts of a business was settled by *Spreckles Sugar Refining Co. v. McClain*, (1904) 192 U. S. 397, 24 Sup. Ct. 376, 48 L. Ed. 496. See *supra*, note 131.

The *Baltic Mining Co.*²⁵⁰ and *Tyee Realty Co.*²⁵¹ Cases returned the income tax to the category to which it "inherently belonged" and, with the exception of *Eisner v. Macomber*,²⁵² there have been no subsequent cases which have necessarily changed this classification;²⁵³ and even *Eisner v. Macomber* has given way to economic imperatives. The dividend cases immediately following the *Macomber* decision refused to accept its mandate to look to the substance of the tax. Dividends which gave the stockholder a slightly different legal interest in a corporation were taxed as income,²⁵⁴ but the measure of that tax was not the value of the new interest; the measure was the market value of the share of stock received from the corporation.²⁵⁵ Thus the income tax cases recognized the outstanding characteristic of an excise,—the distinction between the subject and the measure of a tax.²⁵⁶ This recognition,

²⁵⁰ (1916) 240 U. S. 103, 36 Sup. Ct. 278, 60 L. Ed. 546.

²⁵¹ (1916) 240 U. S. 115, 36 Sup. Ct. 281, 60 L. Ed. 554.

²⁵² (1920) 252 U. S. 189, 40 Sup. Ct. 189, 64 L. Ed. 521. "Viewed against the cases that succeeded it, *Eisner v. Macomber* loses greatly in magnitude. Restricted on all sides to its facts, its bold definition of income partly discarded in result and subsequently regarded as a futile attempt to confine a term that must remain elastic." Magill, *Taxable Income* (1936) 67.

²⁵³ Even *Edwards v. Cuba Railroad Co.*, (1925) 268 U. S. 628, 45 Sup. Ct. 614, 69 L. Ed. 1124, may be considered as a case which turned on an interpretation of a statute rather than on the interpretation of the constitution.

²⁵⁴ See the cases on corporate reorganization: *United States v. Phellis*, (1921) 257 U. S. 156, 42 Sup. Ct. 63, 66 L. Ed. 180; *Rockefeller v. United States*, (1921) 257 U. S. 176, 42 Sup. Ct. 68, 66 L. Ed. 186; *Cullinan v. Walker*, (1923) 262 U. S. 134, 43 Sup. Ct. 495, 67 L. Ed. 906; *Marr v. United States*, (1925) 268 U. S. 536, 45 Sup. Ct. 575, 60 L. Ed. 1079. Dividends in property: *Peabody v. Eisner*, (1918) 247 U. S. 347, 38 Sup. Ct. 546, 62 L. Ed. 1152.

²⁵⁵ In *Towne v. Eisner*, (1918) 245 U. S. 418, 426, 38 Sup. Ct. 158, 159, 62 L. Ed. 392, where the Court held that stock dividends did not constitute income within the meaning of the 1909 Act, this difference was recognized by Mr. Justice Holmes, who observed that: "If the plaintiff gained any small advantage by the change, it certainly was not an advantage of \$417,450, the sum upon which he was taxed." *Powell*, *Income from Corporate Dividends*, (1922) 35 Harv. L. Rev. 363.

²⁵⁶ The same comment also applies to cash dividends received by a stockholder who purchased shares at a price which reflected the undistributed earnings of the corporation. Mr. Justice Pitney, in *United States v. Phellis*, (1921) 257 U. S. 156, 171, 42 Sup. Ct. 63, 66, 66 L. Ed. 180, recognized this contention when he said that: "the possibility of occasional instances of apparent hardship in the incidence of the tax may be conceded. Where, as in this case, the dividend constitutes a distribution of profits accumulated during an extended period and bears a large proportion to the par value of the stock, if an investor happened to buy stock shortly before the dividend, paying a price enhanced by an estimate of the capital plus the surplus of the company, and after distribution of the surplus, with corresponding reduction in the intrinsic and market value of the shares, he was called upon to pay a tax upon the dividend received, it might look in this case like a tax upon his capital." However, this objection was avoided on the ground that "presumably the prospect of a dividend in-

coupled with the fact that Congress may tax as income that which is not income, necessarily conflicts with the premise upon which the *Macomber Case* was based, namely, that in order to give the apportionment clause "proper force and effect . . . it becomes essential to distinguish between what is and what is not 'income' . . . and to apply the distinction . . . according to truth and substance, without regard to form."²⁵⁷ Furthermore, a recent case has intimated that a shareholder may be subject to an income tax even though he does not receive a new interest in the corporation.²⁵⁸ *Collector v. Hubbard*²⁵⁹ which had previously adopted this view, was expressly disapproved by *Eisner v. Macomber*. A revival of the earlier principle would make the position of the five justices who decided the later case untenable.²⁶⁰

CONCLUSION

At best the determination of annual income "is the result of good guessing."²⁶¹ So much of it is based on estimates that the result can only be approximate.²⁶² Perhaps no two accountants would reach the same result if given the same basic materials.²⁶³ Yet in spite of its inaccuracy the estimates are so important that even greater errors are accepted in order to obtain increasingly frequent samplings of the current fortunes of an enterprise.²⁶⁴

fluenced the price paid, and was discounted by the prospect of an income tax to be paid thereon,"—a presumption which may be difficult actually to demonstrate in practice.

²⁵⁷(1920) 252 U. S. 189, 206, 40 Sup. Ct. 189, 193, 64 L. Ed. 521.

²⁵⁸In *Helvering v. National Grocery Co.*, (1938) 304 U. S. 282, 288, 58 Sup. Ct. 932, 935, 82 L. Ed. 1346, Mr. Justice Brandeis said that "the sole owner of the business could not by conducting it as a corporation prevent Congress, if it choose to do so, from laying on him individually the tax upon the year's profits."

²⁵⁹(1871) 12 Wall. (U.S.) 1, 20 L. Ed. 272. The 1864 act required the taxpayer to report his share of the corporate earnings as a part of his individual income even though such income had not been distributed. The Court sustained the provision.

²⁶⁰The taxation of undistributed profits on the basis of a stock dividend would not appear to be an unreasonable classification.

²⁶¹Montgomery, Accounting and the Concept of Income in Magill, *Lectures on Taxation* (1932) 42, 43.

²⁶²"We like to think of income as something reasonably possible to determine with accuracy, but the moment we deal with the major elements which form the bases of the determination, we find that estimates and opinions rather than facts and figures comprise the largest percentage of the factors which must be used to arrive at any result at all." Montgomery, Accounting and the Concept of Income in Magill, *Lectures on Taxation* (1932) 40.

²⁶³1 National Industrial Conference Board, *The Shifting and Effects of the Federal Corporation Income Tax* (1928) 35.

²⁶⁴See Paton and Littleton, *An Introduction to Corporate Accounting Standards* 22.

If all business were begun and concluded within a short period of time the computation of income would be easier and far more accurate than that actually experienced in ordinary business. It is a relatively simple matter to determine the amount of capital at the beginning and at the end of an enterprise, add to the increase or subtract from the decrease any payments made to the owners and determine the net profit or loss. Unfortunately, the needs of government cannot wait upon the conclusion of a business which may extend over a period of years. It thus becomes necessary for tax purposes to estimate the income of an individual or of a corporation at relatively frequent intervals. It is known in advance that activities of any size and variation will necessarily entail rough approximations, arbitrary allocations and frequent errors. But if income is to be computed on an annual basis such defects and injustices are inevitable.

When income is estimated for the information of management, owners, and existing and potential creditors these inaccuracies are accepted as a matter of course. Their inevitable presence is appreciated and those using the information make whatever corrections they think the circumstances require. There is no immediate and readily perceivable out-of-pocket loss as the result of the use of estimates and rules of thumb. But when it comes to income taxation, entirely different considerations apply.²⁶⁵ The fundamental conservatism of the accountant works very well when income statements are prepared for credit purposes, but it is in direct conflict with the necessities of the tax collector.²⁶⁶ Management is content with arbitrary estimates and rigid accounting rules when the reports are compiled for informative purposes, but when the application of such techniques is the direct cause of the pay-

²⁶⁵Gilman, *Accounting Concepts of Profit* (1939) iv, 17; Wuller, *Concepts of Taxable Income II: The American Contribution*, (1938) 35 *Pol. Sci. Q.* 557, 580.

²⁶⁶"His methods appear to be founded upon profound mistrust of both his professional colleagues and his employers. The reputable accountant never loses sight of the fact that his income statements are influential in matters of dividend policy. Income, for him, is perhaps only what may be reported safely to unsophisticated directors as income. He aims, it would seem, never to ascertain what income is, in any really definable sense, but rather to devise rules of calculation which will make the result a minimum or at least give large answers only in the future. Conventional accounting, moreover, not only employs a procedure with a markedly conservative bias but promptly repudiates this procedure whenever it shows signs of working the other way. When prices drawn from actual transactions on his books affords excessive estimates, the accountant promptly appeals to the market for his valuations." Simons, *Personal Income Taxation* (1938) 81.

ment of large sums of money in taxes there is strong objection to their use. Nevertheless, if an income tax is to be collected arbitrary rules must be established in order to determine the amount subject to the tax.²⁶⁷

That Congress may tax income on an annual basis is too well settled to be questioned. As was said in *Burnet v. Sanford & Brooks Co.*,²⁶⁸

"The computation of income annually as the net result of all transactions within the year was a familiar practice, and taxes upon income so arrived at were not unknown, before the sixteenth amendment. . . . While, conceivably, a different system might be devised by which the tax could be assessed, wholly or in part, on the basis of the finally ascertained results of the particular transactions, Congress is not required by the amendment to adopt such a system in preference to the more familiar method, even if it were practicable."

As a necessary corollary to the power to tax on an annual basis Congress may specify the time when an item of income is to be included in the taxpayer's return and the time when a deduction from income may be made. Whether income is to be reported in the year earned, the year due, or the year actually received, and whether expenses are to be deducted in the year incurred, in the year actually paid, or in the year in which the expenditure results in profit are matters falling within the sphere of proper regulation. All of these matters involve so many questions of judgment and differences of opinion that any regulation enacted by Congress is not likely to be so violative of the "commonly understood meaning" of income as to raise a serious constitutional question.

Additional control over the method of ascertaining income for tax purposes is found in the power to provide reasonable regulations for the purpose of preventing tax avoidance and evasion. Unless Congress has the power to prescribe objective tests for the realization of income and loss and for the allocation of expense it would be very easy for the taxpayer, during years of

²⁶⁷That such arbitrary rules are not entirely without justification seems clear. "Books can be made to show almost any condition desired to be shown, and reports can be drawn up in such a way that though they do not portray the actual condition, they are not false." Gerstenberg, *Financial Organization and Management* (1932) 743, 744.

"So long as accounting standards are not hardened, and the law does not impose any specific canons, directors and their accountants may frame their figures, within limits, much as they choose." Berle and Means, *The Modern Corporation and Private Property* (1934) 203.

²⁶⁸(1931) 282 U. S. 359, 365, 51 Sup. Ct. 150, 152, 75 L. Ed. 383.

large profits, to "minimize" gains and to be unduly pessimistic about losses and expense.

Congress, having the power to require an annual basis for reporting income, may limit the deductions to events which were allocable to that period. Many income tax statutes have reflected the belief that an annual basis of taxation is arbitrary and fails in many instances to indicate properly the taxpayer's ability to pay. Corrective measures in the form of provisions permitting the carrying-forward of losses or permitting the averaging of several years' results have frequently been made a part of income tax legislation.²⁶⁹ But whatever reasons of fairness may be advanced for such relief, no constitutional objection to the denial of a deduction for past losses is likely to be raised. To quote again from *Burnet v. Sanford & Brooks Co.*²⁷⁰

"A taxpayer may be in receipt of net income in one year and not in another. The net result of the two years, if considered in a single taxable period, might still be a loss; but it never has been supposed that that fact would relieve him from a tax on the first, or that it affords any reason for postponing the assessment of the tax until the end of a lifetime, or for some other indefinite period, to ascertain more precisely whether the final outcome of the period, or for a given transaction, will be a gain or a loss."

Although Congress may tax on an annual basis and may ignore past losses, a more fundamental problem is involved in the consideration of the meaning of annual income. Since the amendment provides for the taxation of "incomes" without apportionment, there is some basis for the contention that the constitution expressly permits the taxation of the profits from the separate activities of the taxpayer during the year in question. Consequently, if Congress so provides, a person may be said to have a taxable profit for the year even though his affairs were conducted at a serious loss. Such may be the result of an income tax assessed on profitable transactions without allowing a deduction for losses from unprofitable activities. Yet it seems clear that Congress may tax incomes on this basis. That Congress may tax a single type of enterprise is definitely settled.²⁷¹ Furthermore, Congress may limit losses during the year to gains from the

²⁶⁹See Altman, *Net Losses and the Taxable Year*, (1934) 28 Ill. L. Rev. 525.

²⁷⁰(1931) 282 U. S. 359, 364, 365, 51 Sup. Ct. 150, 152, 75 L. Ed. 383.

²⁷¹*United States v. Hudson*, (1937) 299 U. S. 498, 57 Sup. Ct. 309, 81 L. Ed. 370.

same kind of activity.²⁷² It is but a short step to the position that Congress may deny the deduction of all losses.^{272a}

That Congress may deny the deduction of expenses directly allocable to the "income" subject to the tax was settled so far as deductions for depletion and interest were concerned as early as 1916. Starting from this premise, the Supreme Court, the lower federal courts and the board of tax appeals have expanded the principle so that it may be said to include all deductions from gross income. At least the courts have *said* that Congress may limit or deny deductions at will.

However, it may be argued that the courts have not actually held that all deductions are a matter of congressional grace and that the decisions containing statements to this effect may be easily reconciled with a net income concept of the sixteenth amendment. It may be pointed out that in some of the cases the decisions were in the taxpayer's favor and the deductions permitted²⁷³ while in others the remarks did not even remotely pertain

²⁷²*Helvering v. Winmill*, (1938) 305 U. S. 79, 59 Sup. Ct. 45, 83 L. Ed. 52; *Mente v. Eisner*, (C.C.A. 2d Cir. 1920) 266 Fed. 161; *Cohn v. United States*, (1938) 91 Ct. Cl. 418, 23 F. Supp. 534. In *Edward J. White*, (1938) 37 B. T. A. 1106, the taxpayer was engaged in the business of buying and selling securities and commodities. During the year in question, the taxpayer made large profits trading in commodities, but his losses from trading in stocks exceeded these profits. Section 23(r), Revenue Act of 1932, permitted the deduction of security losses only to the extent of the profits from such transactions. Although it was argued that since there was no income for the year any unapportioned tax would violate art. I, sec. 9 of the constitution, the board rejected the contention and held the tax on the commodity profits valid. See also *Manufacturers Trust Co. v. United States*, (1940) 92 Ct. Cl. 622, 32 F. Supp. 289, 296 where under the Silver Purchase Act of 1934, the taxpayer was not permitted to deduct unprofitable silver sales from profitable transactions.

^{272a}*Manufacturers Trust Co. v. United States*, (1940) 92 Ct. Cl. 622, 32 F. Supp. 289, cert. den. (1941) 312 U. S. 691, 61 Sup. Ct. 710.

²⁷³*Prairie Oil & Gas Co. v. Motter*, (C.C.A. 10th Cir. 1933) 66 F. (2d) 309, s. c. (D. Kan. 1932) 1 F. Supp. 464 (basis for depletion to purchaser held to be cost of stock and not cost of property to liquidated corporation); *Chisolm v. United States*, (1937) 85 Ct. Cl. 701, 19 F. Supp. 274 (life beneficiary permitted to deduct depreciation from receipts from trust fund where trustee not required to maintain corpus in undepreciated state); *Champlin v. Commissioner*, (C.C.A. 10th Cir. 1935) 78 F. (2d) 905 (depletion allowance not to be reduced because of cloud on taxpayer's title); *Pleasants v. United States*, (1938) 87 Ct. Cl. 751, 22 F. Supp. 964, s. c. (1939) 305 U. S. 357, 59 Sup. Ct. 282, 83 L. Ed. 217 (charitable contribution limitation applies to net income without regard to capital net loss); *Houston Production Co. v. United States*, (S.D. Tex. 1933) 4 F. Supp. 715 (inconsistent claim by taxpayer); *Craik v. United States*, (1940) 90 Ct. Cl. 345, 31 F. Supp. 132 (that part of the partnership income from sources without United States held not taxable to non-resident alien); *Kentucky Tobacco Products Co. v. Lucas*, (W. D. Ky. 1925) 5 F. (2d) 723 (1913 value of contract may be deducted over life of contract as "obsolescence"); *Courier Journal Job Printing Co. v. Glenn*, (W.D. Ky. 1941) 37 F. Supp. 55, 58 (loss properly deducted); *Safe Deposit & Trust Co. v. Magruder*, (D. Md. 1940) 34 F. Supp. 199, 203 (loss properly deducted).

to the question being decided.²⁷⁴ A great many of the cases involved deductions for current²⁷⁵ or for past losses.²⁷⁶ Others

²⁷⁴*Anderson v. Helvering*, (1940) 310 U. S. 404, 60 Sup. Ct. 952, 84 L. Ed. 1277 (payments made for oil well included in gross income); *Langford Investment Co. v. Commissioner*, (C.C.A. 5th Cir. 1935) 77 F. (2d) 468 (compromise by trustee of a claim that the trust was a fraudulent conveyance); *Faber v. United States*, (1935) 81 Ct. Cl. 980, 10 F. Supp. 602, cert. den. (1935) 296 U. S. 596, 56 Sup. Ct. 115, 80 L. Ed. 422 (deduction from gross estate of decedent); *Empire Trust Co. v. Commissioner*, (C.C.A. 4th Cir. 1938) 94 F. (2d) 307, 310 (estate tax decision); *Markwell's Estate v. Commissioner*, (C.C.A. 7th Cir. 1940) 112 F. (2d) 253, 255 (estate tax decision).

²⁷⁵*White v. United States*, (1938) 305 U. S. 281, 59 Sup. Ct. 179, 83 L. Ed. 172 (limitation of amount of deductible loss); *Helvering v. Chester N. Weaver Co.*, (1938) 305 U. S. 293, 59 Sup. Ct. 185, 83 L. Ed. 180 (limitation of amount of deductible loss); *Neuberger v. Commissioner*, (C.C.A. 2d Cir. 1939) 104 F. (2d) 649 (personal losses not deductible from partnership profits); *Helvering v. Obici*, (C.C.A. 4th Cir. 1938) 97 F. (2d) 431 aff'd (1939) 305 U. S. 468, 59 Sup. Ct. 260, 83 L. Ed. 202 (loss of property not used in business); *Manufacturers Trust Co. v. United States*, (1940) 92 Ct. Cl. 622, 32 F. Supp. 289, 296 (losses not set off against gains under Silver Purchase Act of 1934); *First National Bank & Trust Co. v. United States*, (C.C.A. 5th Cir. 1941) 115 F. (2d) 194, 195 (limited deduction for loss); *Winmill v. Commissioner*, (C.C.A. 2d Cir. 1937) 93 F. (2d) 494, rev'd on another issue, (1938) 305 U. S. 79, 59 Sup. Ct. 45, 83 L. Ed. 52 (taxpayer denied right to deduct personal loss from joint profits); *Davis v. United States*, (C.C.A. 2d Cir. 1937) 87 F. (2d) 323 (limitation on deductible loss); *Johnston v. Commissioner*, (C.C.A. 2d Cir. 1936) 86 F. (2d) 732, cert. den., (1937) 301 U. S. 683, 57 Sup. Ct. 784 (deduction of individual non-capital loss from share of partnership profits from sale of non-capital assets); *Avery v. Commissioner*, (C.C.A. 7th Cir. 1936) 84 F. (2d) 905 (limitation on deductible loss); *Pennsylvania Company for Insurances v. Commissioner*, (C.C.A. 3d Cir. 1935) 75 F. (2d) 719 (new corporation denied deduction for losses suffered during earlier part of year by its predecessor); *Brandon Corporation v. Commissioner*, (C.C.A. 4th Cir. 1934) 71 F. (2d) 762 (new corporation may not deduct losses suffered earlier in year by old corporation); *White v. Commissioner*, (C.C.A. 9th Cir. 1932) 61 F. (2d) 726 (partnership assumed loss of member); *Ludington v. McCaughn*, (C.C.A. 3d Cir. 1924) 1 F. (2d) 689, rev'd (1925) 268 U. S. 106, 45 Sup. Ct. 423; *Cohn v. United States*, (1938) 91 Ct. Cl. 418, 23 F. Supp. 534 (loss from sale of securities deductible only to extent of profits from such transactions); *Edward J. White*, (1938) 37 B. T. A. 1006 (security losses deductible only to extent of such profits); *Frederick H. Wood*, (1936) 34 B. T. A. 1252 (loss from liquidation of trust not deductible); *Word Specialty Manufacturing Co.*, (1936) 34 B. T. A. 974 (corporation assumed expense of affiliate); *Otto Keusch*, (1931) 23 B. T. A. 216 (limitation on amount of deductible loss); *Samuel S. Bloch*, (1929) 16 B. T. A. 425 (basis for determining loss).

²⁷⁶*New Colonial Ice Co. v. Helvering*, (1934) 292 U. S. 435, 54 Sup. Ct. 788, 78 L. Ed. 1348, s. c. (C.C.A. 2d Cir. 1933) 66 F. (2d) 480 (new corporation claimed deduction for predecessor's loss); *Charles Ilfield Co. v. Hernandez*, (1934) 292 U. S. 62, 54 Sup. Ct. 596, 78 L. Ed. 1127 (part losses deducted in year suffered); *Woolford Realty Co. v. Rose*, (1932) 286 U. S. 319, 52 Sup. Ct. 568, 76 L. Ed. 1128 (deduction for loss of subsidiary before affiliation denied); *Burnet N. Thompson Oil & Gas Co.*, (1931) 283 U. S. 301, 51 Sup. Ct. 418, 75 L. Ed. 1049 (corporation claimed an allowance for depletion large enough to restore disallowed actual depletion of past years); *Commissioner v. Trustees of Lumber Inv-Ass'n*, (C.C.A. 7th Cir. 1938) 100 F. (2d) 18 (net loss carry-over); *Lucky Tiger-Combination Gold Mining Co. v. Crooks*, (C.C.A. 8th Cir.

related to exemptions,²⁷⁷ or to deductions relating to capital expenditures rather than ordinary expense²⁷⁸—or if it was an expense, it was incurred in securing tax-exempt income,²⁷⁹ or it was

1938) 95 F. (2d) 885 (deduction for past depletion refused); *Remco S. S. Co. v. Commissioner*, (C.C.A. 9th Cir. 1936) 82 F. (2d) 988, cert. den., (1936) 299 U. S. 555, 57 Sup. Ct. 17, 81 L. Ed. 408 (net loss carry-over); *Weber Flour Mills Co. v. Commissioner*, (C.C.A. 10th Cir. 1936) 82 F. (2d) 764 (loss of old corporation not deductible); *Van Vleck v. Commissioner*, (C.C.A. 2d Cir. 1935) 80 F. (2d) 217, cert. den. (1936) 298 U. S. 656, 56 Sup. Ct. 676, 80 L. Ed. 1382 (net loss carry-over); *Planters Cotton Oil Co. v. Hopkins*, (C.C.A. 5th Cir. 1931) 53 F. (2d) 825, aff'd (1932) 286 U. S. 332, 52 Sup. Ct. 509 (net loss carry-over); *Kansas City Southern Ry. v. Commissioner*, (C.C.A. 8th Cir. 1931) 52 F. (2d) 372 (past obsolescence); *Miller v. Commissioner*, (C.C.A. 9th Cir. 1940) 115 F. (2d) 479, 480 (net loss carry-over).

²⁷⁷*Robert P. Scripps*, (1936) 33 B. T. A. 962; *Scripps v. Commissioner*, (C.C.A. 6th Cir. 1938) 96 F. (2d) 492 and *Bagnall v. Commissioner*, (C.C.A. 9th Cir. 1938) 96 F. (2d) 956, involved the provision permitting the deduction of estate taxes from the income of the estate. *Avery v. Commissioner*, (C.C.A. 7th Cir. 1936) 84 F. (2d) 905 and *Old Colony Trust Co. v. Commissioner*, (C.C.A. 1st Cir. 1936) 87 F. (2d) 131, rev'd, (1937) 301 U. S. 379, 57 Sup. Ct. 813, 81 L. Ed. 1169, related to the deduction for charitable contributions; *Cooperative Oil Ass'n v. Commissioner*, (C.C.A. 9th Cir. 1941) 115 F. (2d) 666, 668, 669 (patronage dividends not deductible); *Chicago & N. W. R. Co. v. Commissioner*, (C.C.A. 7th Cir. 1940) 114 F. (2d) 882, 887 (charitable contribution).

²⁷⁸*Helvering v. Winnmill*, (1938) 305 U. S. 79, 59 Sup. Ct. 45, 83 L. Ed. 52, (commissions required to be capitalized rather than deducted as expense); *United States v. Sentinel Oil Co.*, (C.C.A. 9th Cir. 1940) 109 F. (2d) 854 (cost of drilling well part of purchase price and must be capitalized); *Walsh-McGuire Co. v. Commissioner*, (C.C.A. 6th Cir. 1938) 97 F. (2d) 983 (capitalize payments of taxes due on land at time of purchase); *Bermont Oil Co. v. Helvering*, (1937) 67 App. D. C. 256, 91 F. (2d) 710 (indemnification expense part of purchase price and must be capitalized); *Crowley v. Commissioner*, (C.C.A. 6th Cir. 1937) 89 F. (2d) 715 (attorney's fees paid to acquire stock of corporation); *Motion Picture Capital Corporation v. Commissioner*, (C.C.A. 2d Cir. 1936) 80 F. (2d) 872 (organization, merger and stock listing expenses); *Baltimore & Ohio R. Co. v. Commissioner*, (C.C.A. 4th Cir. 1935) 78 F. (2d) 460 (discount on stock and underwriters' fees); *Surety Finance Co. v. Commissioner*, (C.C.A. 9th Cir. 1935) 77 F. (2d) 221 (organization expense and commissions on sale of stock); *Barbour Coal Co. v. Commissioner*, (C.C.A. 10th Cir. 1934) 74 F. (2d) 163, cert. den. (1935) 295 U. S. 731, 55 Sup. Ct. 643 (commissions on sale of preferred stock); *Continental Pipe Mfg. Co. v. Poe*, (C.C.A. 9th Cir. 1932) 59 F. (2d) 694 (expenditures made to protect investment in bonds must be capitalized); *William F. Humphrey*, (1935) 33 B. T. A. 442 (expenditures made to protect corporation must be capitalized).

²⁷⁹*Helvering v. Inter-Mountain Life Insurance Co.*, (1935) 294 U. S. 686, 55 Sup. Ct. 572, 70 L. Ed. 1227 (deduction of amount added to reserves limited); *Helvering v. Independent Life Ins. Co.*, (1934) 292 U. S. 371, 54 Sup. Ct. 758, 78 L. Ed. 1311 (limitation on deduction for depreciation); *Cleveland Shopping News Co. v. Routzahn*, (C.C.A. 6th Cir. 1937) 89 F. (2d) 902 (fund paid in by subscribers of advertising service not taxed when received and may not be deducted when returned to subscribers); *Phipps v. Bowers*, (S.D. N.Y. 1930) 46 F. (2d) 164 (interest on loan used to purchase tax-exempt securities not deductible); *New World Insurance Co. v. United States*, (1939) 89 Ct. Cl. 558, 26 F. Supp. 444, cert. den. (1939) 308 U. S. 612, 60 Sup. Ct. 179, 84 L. Ed. 512 (limita-

a personal expenditure.²⁸⁰ And finally, there are those cases which dealt with the method of accounting used by the taxpayer,²⁸¹ the accounting period in which a deduction should be taken²⁸² and the

tion on deduction for general expense); *Waldorf Astor*, (1935) 31 B. T. A. 1009 (deduction of foreign tax limited to income taxed by the United States).

²⁸⁰*Dexter v. Commissioner*, (C.C.A. 1st Cir. 1938) 99 F. (2d) 769 (loss on son-in-law's note); *Old Colony Trust Co. v. Commissioner*, (C.C.A. 1st Cir. 1936) 87 F. (2d) 131, rev'd (1937) 301 U. S. 379, 57 Sup. Ct. 813, 81 L. Ed. 1169 (charitable contribution); *Avery v. Commissioner*, (C.C.A. 7th Cir. 1936) 84 F. (2d) 905, disapproved, *United States v. Pleasants*, (1939) 305 U. S. 357, 59 Sup. Ct. 281, 83 L. Ed. 217 (charitable contributions); *Lindley v. Commissioner*, (C.C.A. 2d Cir. 1933) 63 F. (2d) 807 (attorney's fees in action to recover estate tax); *Lloyd v. Commissioner*, (C.C.A. 7th Cir. 1932) 55 F. (2d) 842 (attorney's fees in action for slander); *Kenan v. Bowers*, (C.C.A. 2d Cir. 1931) 50 F. (2d) 112 (additional fees paid trustees by beneficiary); *Helen H. Heilbroner*, (1936) 34 B. T. A. 1200 (commission paid for collecting income).

²⁸¹*United States v. O. J. Morrison Stores*, (C.C.A. 4th Cir. 1938) 99 F. (2d) 77 (failed to supply information required); *American Can Co. v. Bowers*, (C.C.A. 2d Cir. 1929) 35 F. (2d) 832 (inventory valuation); *Robinson-Davis Lumber Co. v. Crooks*, (W.D. Mo. 1931) 50 F. (2d) 638 (failed to charge off bad debt in year ascertained to be worthless); *Consolidated Dry Goods Co. v. United States*, (D. Mass. 1940) 35 F. Supp. 523, 525 (reserve for bad debts).

²⁸²*Du Pont v. Deputy*, (1940) 308 U. S. 488, 60 Sup. Ct. 363, 84 L. Ed. 416 (expenditure capitalized); *United States v. Sentinel Oil Co.*, (C.C.A. 9th Cir. 1940) 109 F. (2d) 854 (expenditure capitalized); *United States v. Donaldson Realty Co.*, (C.C.A. 8th Cir. 1939) 106 F. (2d) 509 (expenditure to be capitalized); *Burdan v. Commissioner*, (C.C.A. 3d Cir. 1939) 106 F. (2d) 207 (failed to prove year loss realized); *Jones v. Commissioner*, (C.C.A. 9th Cir. 1939) 103 F. (2d) 681 (failed to prove the loss was suffered in the year claimed); *Walsh-McGuire Co. v. Commissioner*, (C.C.A. 6th Cir. 1938) 97 F. (2d) 983 (expenditure should have been capitalized); *Helvering v. Obici*, (C.C.A. 4th Cir. 1938) 97 F. (2d) 431, aff'd, (1939) 305 U. S. 468, 59 Sup. Ct. 260, 83 L. Ed. 292 (depreciated value of property basis for deductible loss); *Sabath v. Commissioner*, (C.C.A. 7th Cir. 1938) 100 F. (2d) 569 (failed to show year in which stock became worthless); *Bermont Oil Co. v. Helvering*, (1937) 67 App. D. C. 256, 91 F. (2d) 710 (expenditure should be capitalized); *Walker v. Commissioner*, (C.C.A. 5th Cir. 1937) 91 F. (2d) 297 (gift incomplete in year deducted); *Crowley v. Commissioner*, (C.C.A. 6th Cir. 1937) 87 F. (2d) 715 (expenditure should be capitalized); *Merchants Bank Bldg. Co. v. Helvering*, (C.C.A. 8th Cir. 1936) 84 F. (2d) 478 (expenditure should have been capitalized); *McGinley Corporation v. Commissioner*, (C.C.A. 5th Cir. 1936) 82 F. (2d) 56 (failed to show that loss was realized); *Shapleigh Hardware Co. v. United States*, (C.C.A. 8th Cir. 1936) 81 F. (2d) 697 (cash discounts deducted only when actually taken); *Commissioner v. Riggs*, (C.C.A. 3d Cir. 1935) 78 F. (2d) 1004 (failed to show amount of loss actually realized); *Baltimore & Ohio R. Co. v. Commissioner*, (C.C.A. 4th Cir. 1935) 78 F. (2d) 456 (taxpayer on accrued bases must deduct refund in year due rather than year paid); *Squier v. Commissioner*, (C.C.A. 2d Cir. 1933) 68 F. (2d) 25 (failed to show year in which loss occurred); *Martin v. Commissioner*, (C.C.A. 2d Cir. 1932) 61 F. (2d) 942, cert. den. (1933) 289 U. S. 737, 53 Sup. Ct. 656, 77 L. Ed. 1485 (may not deduct loss in installments); *Continental Pipe Mfg. Co. v. Poe*, (C.C.A. 9th Cir. 1932) 59 F. (2d) 694 (debt must be charged off in year ascertained to be worthless); *Jankowsky v. Commissioner*, (C.C.A. 10th Cir. 1932) 56 F. (2d) 1006 (failed to show amount of loss); *Pugh v.*

regulations for the prevention of avoidance and evasion.²⁸³ The depletion cases may be explained on the ground that the "common understanding" of the meaning of income does not require the deduction of an allowance for wasting assets,²⁸⁴ while the case sustaining the limitation on interest expense may be explained by the fact that such limitation applied only to corporations and that the limitation was necessary to prevent the distribution of dividends under the guise of interest payments and thereby reduce the amount of corporate income subject to the tax.²⁸⁵ Yet even if the remarks contained in more than a hundred cases

Commissioner, (C.C.A. 5th Cir. 1931) 49 F. (2d) 76, cert. denied, (1931) 284 U. S. 642, 52 Sup. Ct. 22 (failed to show that loss was realized); Spring Canyon Coal Co. v. Commissioner, (C.C.A. 10th Cir. 1930) 43 F. (2d) 78 (Workmen's compensation expense deducted only when actually paid); New Creek Co. v. Lederer, (C.C.A. 3d Cir. 1924) 295 Fed. 433 (prorata deduction of royalty value); *Pierre S. du Pont*, (1938) 37 B. T. A. 1198 (expenditure capitalized); *Westerfield v. Rafferty*, (E.D. N.Y. 1925) 4 F. (2d) 590 (expenditure should have been capitalized); *American Arch Co.*, (1935) 33 B. T. A. 705 (expenditure should have been deducted in year made instead of being capitalized); *S. E. Thomason*, (1935) 33 B. T. A. 576 (taxpayer on cash basis may not deduct accrued interest); *William F. Humphrey*, (1935) 33 B. T. A. 442 (expenditure to be capitalized rather than deducted as expense); *Paul Prybil*, (1934) 31 B. T. A. 164 (failed to show year in which loss occurred).

²⁸³*O'Laughlin v. Helvering*, (1935) 65 App. D. C. 135, 81 F. (2d) 269 (failed to show full details of expenditure alleged to have been made); *Commissioner v. Riggs*, (C.C.A. 3d Cir. 1935) 78 F. (2d) 1004 (purchase and sale to reduce taxes); *Hecht v. United States*, (1932) 74 Ct. Cl. 748, 54 F. (2d) 968 (salary paid son deemed excessive).

²⁸⁴See *supra* note 166. Among the cases falling within this category are: *Helvering v. Mountain Producers Corporation*, (1938) 303 U. S. 376, 58 Sup. Ct. 623, 82 L. Ed. 907 (amount of discovery value); *Helvering v. Bankline Oil Co.*, (1938) 303 U. S. 362, 58 Sup. Ct. 616, 82 L. Ed. 897 (casing-head gas contracts); *Palmer v. Bender*, (C.C.A. 5th Cir. 1932) 57 F. (2d) 32, *rev'd*, (1933) 287 U. S. 551, 53 Sup. Ct. 225, 77 L. Ed. 489 (partly entitled to deduct discovery value); *Darby-Lynde Co. v. Commissioner*, (C.C.A. 10th Cir. 1931) 51 F. (2d) 32 (partly entitled to deduct discovery value); *Jefferson & Clearfield Coal Co. v. United States*, (1936) 83 Ct. Cl. 712, 14 F. Supp. 918 (1913 value less than cost; depletion basis on 1913 value sustained); *Hurley v. Davis*, (N.D. Okla. 1935) 10 F. Supp. 365 (casing-head gas contracts); *Lizzie H. Glide*, (1933) 27 B. T. A. 1264 (bonus payments received on lease not subject to 27½% depletion when wells not yet in operation); *Phoenix Oil Production Co.*, (1932) 25 B. T. A. 1239 (discovery value eliminated); *Commodore Mining Co. v. Commissioner*, (C.C.A. 10th Cir. 1940) 111 F. (2d) 131, 133 (discovery value abandoned); *J. E. Riley Inv. Co. v. Commissioner*, (C.C.A. 9th Cir. 1940) 110 F. (2d) 655, 658 (depletion controversy).

²⁸⁵See the suggestion to this effect in connection with the 1909 Act made by Day, J., in *Flint v. Stone Tracy Co.*, (1911) 220 U. S. 107, 173, 31 Sup. Ct. 342, 358, 55 L. Ed. 389. An alternative explanation would be that the sixteenth amendment adopted the 1909 Act's definition of income and a similar limitation was found in that statute. See *Bowers v. Kerbaugh-Empire Co.*, (1926) 271 U. S. 170, 174, 46 Sup. Ct. 449, 451, 70 L. Ed. 886 (income under the sixteenth amendment said to be same as income under the 1909 Act). Cf. *Brown-Rogers-Dixon Co. v. Commissioner*, (C.C.A. 4th Cir. 1941) 122 F. (2d) 347.

amount to mere dicta, their cumulative force is so great that the doctrine of the *New Colonial Ice Co. Case* is not likely to be seriously questioned in the future. Congress may tax gross income.²⁸⁶

Shocking as this principle is to the accountant, it unfortunately does not grossly violate the vague and inaccurate definition of the word "income" as used by laymen in 1913 and, to a lesser extent, even today.²⁸⁷ The man-in-the-street often refers to his profit as being the difference between cost and selling price without meticulously estimating his overhead and other expenses. If his oversight is mentioned to him, he will, of course, instantly agree that he has overstated his profit, but he will, in the next breath, repeat his inaccuracy. Accountants themselves have only recently frowned on the use of "gross income" in financial statements, and its use has by no means disappeared. Therefore, an income tax statute which attempts to tax gross income will not so obviously violate the meaning of "incomes" as used in the sixteenth amendment as to warrant a prediction of unconstitutionality under a strict, direct-tax theory of income taxation. Clearly there is no likelihood of such a prediction if the Court should recognize the genesis of the doctrine of congressional absolutism over deductions.

However, this recognition is imperative if Congress should attempt to tax gross receipts by the means of an income tax. It is easy enough to imagine circumstances which would require the raising of tremendous revenues to meet a continued national emergency; a transactions-income tax is not beyond the realm of possibility. If Congress should broaden the income tax to include all receipts, a far more serious question of the power of Congress over deductions would be raised. There is still a tendency to think of the income tax exclusively in terms of the *Pollock Case* and the sixteenth amendment and to ignore the other taxing powers of the federal government.

If the Court should return to the doctrine that an income tax is an excise rather than a direct tax, most of the objections to a tax on the receipts from both profitable and unprofitable transactions would be removed. Congress may tax property other than

²⁸⁶Paul and Mertens, *The Law of Federal Income Taxation* (1934) and secs. 1.10, 4.22, 7.29, 7.44, 20.01, 21.01, 26.25. Cf. Mertens, 1939 Supplement, sec. 4.22.

²⁸⁷See Dewing, *Financial Policy of Corporations* (1926) 457.

real estate,²⁸⁸ and the tax may be assessed more than once upon such property.²⁸⁹ In addition, Congress may tax the sale,²⁹⁰ gift,²⁹¹ and inheritance²⁹² of both real and personal property and the tax may be measured by the gross value of the sale, gift, and inheritance. Congress may also tax the gross receipts of a business, and the tax may be measured by receipts not essential to the conduct of the enterprise.²⁹³ The business concept is a flexible one and it could be easily extended to cover a single transaction such as the exchange of assets or the payment of a debt. It would thus seem clear that Congress could tax gross receipts by a statute framed in the character of an excise. Furthermore there would appear to be no insuperable constitutional objection to a graduated excise tax on gross receipts. Graduated taxes have been levied by Congress²⁹⁴

²⁸⁸*Cornell v. Coyne*, (1904) 192 U. S. 418, 24 Sup. Ct. 383, 48 L. Ed. 504; *Cincinnati Soap Co. v. United States*, (1937) 301 U. S. 308, 57 Sup. Ct. 764, 81 L. Ed. 1122; *Pennsylvania v. Fix*, (M.D. Pa. 1934) 9 F. Supp. 272; *Billings v. United States*, (1914) 232 U. S. 261, 34 Sup. Ct. 421, 58 L. Ed. 596; *United States v. Bennett*, (1914) 232 U. S. 299, 34 Sup. Ct. 433, 58 L. Ed. 612; cf. *United States v. Goelet*, (1914) 232 U. S. 293, 34 Sup. Ct. 431; 58 L. Ed. 610; *Pierce v. United States*, (1914) 232 U. S. 290, 34 Sup. Ct. 427, 58 L. Ed. 609. *Jones, Pollock v. Farmers' Loan & Trust Co.*, (1895) 9 Harv. L. Rev. 198, 210. For a tax of one-twenty-fourth of one per cent each month on average deposits "with any person, bank, association, company or corporation, engaged in the business of banking" see (1864) 13 Stat. at L. 277.

²⁸⁹*Patton v. Brady*, (1902) 184 U. S. 608, 22 Sup. Ct. 493, 46 L. Ed. 713.

²⁹⁰*Nicol v. Ames*, (1899) 173 U. S. 509, 19 Sup. Ct. 522, 43 L. Ed. 786; *Thomas v. United States*, (1904) 192 U. S. 363, 24 Sup. Ct. 305, 48 L. Ed. 481; *Alexander Theatre Ticket Office v. United States*, (C.C.A. 2d Cir. 1927) 23 F. (2d) 44; *United Cigar Stores Co. of America v. United States*, (1931) 74 Ct. Cl. 744, 50 F. (2d) 466.

²⁹¹*Bromley v. McCaughn*, (1929) 280 U. S. 124, 50 Sup. Ct. 46, 74 L. Ed. 226.

²⁹²*Knowlton v. Moore*, (1900) 178 U. S. 41, 20 Sup. Ct. 747, 44 L. Ed. 969; *New York Trust Co. v. Eisner*, (1921) 256 U. S. 345, 41 Sup. Ct. 506, 65 L. Ed. 963.

²⁹³*Spreckles Sugar Refining Co. v. McClain*, (1904) 192 U. S. 397, 24 Sup. Ct. 376, 48 L. Ed. 496; *Standard Oil Co. v. McLaughlin*, (C.C.A. 9th Cir. 1933) 67 F. (2d) 111.

²⁹⁴A graduated tax on household furniture was enacted as early as 1816. 3 Stat. at L. 186. A progressively graduated excise tax was sustained in *Pacific American Fisheries v. Alaska*, (1925) 269 U. S. 269, 46 Sup. Ct. 110, 70 L. Ed. 270, a case involving the fifth amendment. However, in *Stewart Dry Goods Co. v. Lewis*, (1936) 294 U. S. 550, 55 Sup. Ct. 525, 79 L. Ed. 1054, a graduated state sales tax was said to be "unjustifiably unequal, whimsical and arbitrary" and therefore violated the due process clause of the fourteenth amendment. There was a strong dissenting opinion by Cardozo, J., joined in by Brandeis and Stone, JJ. Cf. Seligman, *Progressive Taxation in Theory and Practice*, (1908) 9 Am. Econ. Ass'n Q. 1, 101. "In the United States the progressive principle has been applied in no less than six classes of imposts, namely, the house tax, the income tax, the business tax, the corporation tax, the inheritance tax, and the land tax." A gross receipts tax on *exports* would present a different question. See Note (1916) 30 Harv. L. Rev. 77, 79.

and have been sustained in spite of the objection of the taxpayer and the occasional dissent of a member of the Supreme Court.²⁹⁵ If a graduated tax may be sustained when in the form of an ordinary excise, it is difficult to believe that it would not be sustained today even though in the form of an income tax;²⁹⁶ and such is the necessary effect of a number of Supreme Court decisions.²⁹⁷

The pseudo-economic²⁹⁸ interpretation of direct taxes found in *Pollock v. Farmers' Loan & Trust Co.* was immediately abandoned.²⁹⁹ To avoid the unpleasant task of overruling that unfortunate decision the Court, in effect, accepted the doctrine that the difference between a direct tax and an indirect tax was merely the difference between a statute which used a direct method of describing a tax and one which used an indirect method of describing the same tax.

That part of the *Pollock* decision which denied Congress the power to tax income has been overruled by the sixteenth amendment;³⁰⁰ that part of the decision which extended the definition of a direct tax to include a tax on personal property has never been successfully invoked to strike down an excise tax and the only time that it has been used to strike down an income tax involved a case where Congress attempted to tax the shareholder on the

²⁹⁵E. g., see *supra*, p. 440.

²⁹⁶A combination of the "income" and "excise" tax should present no constitutional difficulty. In sustaining a federal "income" tax on the profit from the sale of municipal bonds, the Court, in *Willcutts v. Bun*, (1931) 282 U. S. 216, 227, 51 Sup. Ct. 127, 75 L. Ed. 304, said that "the tax upon profits . . . [from a sale] is an excise. . . . The federal income tax acts cover taxes of different sorts." For a reference to the combined tax see *Morrissey v. Commissioner*, (1935) 296 U. S. 344, 355, 56 Sup. Ct. 289, 294, 80 L. Ed. 263.

²⁹⁷See *supra*, pp. 461-465.

²⁹⁸See Seligman, *Income Tax* (1914) 538, 579, 580, 581.

²⁹⁹See *supra*, Part IV.

³⁰⁰The widespread belief that *Pollock v. Farmers' Loan & Trust Co.* would have been overruled without the aid of the sixteenth amendment has been greatly strengthened by subsequent decisions of the Supreme Court. In *New York ex rel. Cohn v. Graves*, (1937) 300 U. S. 308, 57 Sup. Ct. 466, 81 L. Ed. 666, the view that an income tax was one on the property and leviable only by the state in which the land was located, was rejected. And in *Graves v. O'Keefe*, (1939) 306 U. S. 466, 480, 59 Sup. Ct. 595, 598, 83 L. Ed. 927, it was said that "The theory, which once won a qualified approval, that a tax on income is legally and economically a tax on its source, is no longer tenable. . . ." See *Hale v. Iowa Board of Assessment*, and *Review*, (1937) 302 U. S. 95, 58 Sup. Ct. 102, 82 L. Ed. 72. See also, *Evans*, *A Constitutional Problem in Federal Income Taxation* (1935) 7 *Rocky Mount. L. Rev.* 85, 98, 99. Cf. *State ex rel. Botkin v. Welsh*, (S.D. 1933) 251 N. W. 189; (1934) 34 *Col. L. Rev.* 780.

"undistributed" profits of a corporation³⁰¹—and even this one case was effectively sterilized by subsequent opinions.³⁰²

But even if the *Pollock* and *Macomber Cases* are not to be expressly overruled, it may be said that for all practical purposes the Supreme Court has returned to the doctrine which had been followed for more than a century, viz., capitation taxes and taxes on real estate must be apportioned; all other taxes must be uniform. In substance the *Hylton Case* delimits the federal taxing power.

At most the *Pollock Case* requires nothing more than the use of artificial and somewhat ludicrous distinctions.³⁰³ The Court has clearly indicated the method which may be used to lay and collect taxes on gross receipts. If the Court should insist that the income tax be used only to tax income or that which vaguely resembles income and thus refuse to make a clean break with the "strange case of *Pollock v. Farmers' Loan & Trust Co.*,"³⁰⁴ a proper observance of the "prescribed rituals" will enable Congress to obtain the result it deems necessary or desirable. But instead of requiring needless experiments in legislative draftsmanship, it is more probable that the Court will return to its concept of the income tax which antedated the *Pollock Case* and immediately preceded *Eisner v. Macomber*.

³⁰¹*Eisner v. Macomber*, (1913) 252 U. S. 189, 40 Sup. Ct. 189, 64 L. Ed. 521.

³⁰²See *supra*, pp. 466-467, and notes 252, 254-256.

³⁰³E. g., Congress is not taxing property or income, but is taxing a *privilege* (which it doesn't grant) *measured by* property or income.

³⁰⁴(1895) 157 U. S. 429, 15 Sup. Ct. 673, 39 L. Ed. 759; (1895) 158 U. S. 601, 15 Sup. Ct. 912, 39 L. Ed. 1108. Lowndes, *Spurious Conceptions of the Constitutional Law of Taxation* (1934) 47 Harv. L. Rev. 628, 646.